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No.

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1982

In re:

W.T. GRANT COMPANY,

Bankrupt.

DAVID COSOFF and HELEN FINKELSTEIN,

Petitioners,

- against -

CHARLES G. RODMAN, as Trustee of W.T. GRANT COMPANY, Bankrupt,

Respondent.

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF
APPEALS FOR THE SECOND CIRCUIT

BRADLEY R. BREWER, ESQ.
BREWER & SOEIRO
Attorneys for Petitioners
799 Broadway
New York, New York 10003
(212) 777-4010

Questions Presented for Review

1. Was a substantial conflict of interests created in violation of principles of law set forth by this Court in Pepper v. Litton, 308 U.S. 295, 300 (1939), and of standards of ethical conduct applicable to attorneys practicing before the federal courts where: (a) an attorney and his law firm sought and received appointment by a bankruptcy court to be attorneys for the bankrupt estate of a corporation; (b) at the time of the appointment, the attorney and his firm were representing and had represented in the past several banks who were leaders of a group of bank creditors who had filed claims as secured creditors with loans of $657.4 million representing approximately 94% of the assets of the bankrupt estate; (c) at the time of the appointment, the attorney and the leading bank creditors knew that a major portion of the attorney's efforts as counsel for the bankrupt estate would involve conducting litigation on behalf of the estate's general creditors and against the bank creditors involving claims by the general creditors that the bank claimants came before the court with unclean hands for which their liens should be declared void and their claims subordinated to those of the untainted general creditors; (d) after the appointment, the attorney and

his firm proceeded to conduct the anticipated massive litigation against the banks on behalf of the general creditors over a period of two years for which the attorney and his firm were paid by the estate several million dollars in legal fees; (e) while the attorney and his firm were purporting to litigate against the bank creditors over claims to hundreds of millions of dollars in cash held by the estate, he and the firm were simultaneously representing some of the lead banks in connection with other and unrelated bankruptcy matters for which the attorneys were paid substantial fees; and (f) when the bank creditors proposed a settlement of the claims at issue between them and the general creditors, the attorney for the estate and the bankruptcy trustee (who, like the estate's attorney, had admittedly received his appointment through connections with the banks and the banks' attorneys) decided to drop their opposition to the banks' claims, abandon all of the positions of fact and law previously asserted by them in the litigation, accept all of the arguments presented by the banks, and enthusiastically recommend to the bankruptcy court that it accept and approve whatever offer the banks had chosen to make as the best result that could be obtained for the general creditors?

2. If those circumstances did create a significant conflict of interests on the part

of the attorney and his firm in violation of legal principles enunciated by this Court, was that conflict sufficiently substantial to require the bankruptcy court (1) to hold the estate's attorney and his firm unqualified (for reasons of potential bias) to evaluate the proposed settlement or to recommend it to the bankruptcy court under applicable provisions of the Bankruptcy Act and (2) to appoint new and independent counsel to investigate the matter and make recommendations to the bankruptcy court regarding the strength of the general creditors' claims against the banks and the fairness of the settlement proposal by the banks?

3. Where a bank's relationship with a corporation is such that it is both (a) a major creditor with approximately $100 million in loans outstanding and (b) a paid fiduciary (indenture trustee) for debentureholders of the corporation with approximately $100 million in bonds outstanding, has the bank committed a clear violation of its fiduciary duties as indenture trustee for the debentureholders for which its interests must be held subordinate to the bankruptcy claims of the debentureholders under the teachings of <u>Pepper v. Litton</u>, 308 U.S. 295 (1939); <u>Dabney v. Chase National Bank</u>, 196 F.2d 668 (2d Cir. 1952), <u>supplemented</u>, 201 F.2d 635 (2d Cir.),

cert. dismissed per stip., 346 U.S. 863 (1953); and related cases* where: (1) the bank, prior to its resignation as indenture trustee in favor of a successor, participated with two other leading bank creditors (as leaders of a bank creditor group) in the negotiation of guaranties and liens from the corporation which would provide the basis for a contention by the banks (which they would not otherwise have had) that their loans were "senior" to the debt obligations held by the debentureholders and (2) the bank participated with two other "lead" banks in exerting influence over the corporation's management and thereby prevented management from completing a transaction by means of which the corporation would have sold certain accounts receivable and used the proceeds to buy the outstanding $100 million in debentures from the holders in the open market market for approximately $30 million?

4. Where (a) two members of a group of bank creditors holding $657 million in claims against a bankrupt corporation had influential representatives on the bankrupt's board of directors before bankruptcy and two other members of the bank creditor group were indenture

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* E.g., U.S. Trust Co. v. First Nat. City Bank, 57 A.D. 2d 285, 296 (1st Dept. 1977), aff'd w/o opinion, 45 N.Y. 2d 869 (1978); Morris v. Cantor, 390 F. Supp. 817 (S.D.N.Y. 1975).

trustees for separate groups of debentureholders with claims adverse to the banks' claims of "senior" status and secured interests, (b) protracted litigation arose in the bankruptcy court which pitted the interests of the banks against those of the general creditors (including the debentureholders) in which the bankruptcy trustee and his attorneys undertook to represent the interests of the general creditors, and (c) the bank claimants proposed a settlement with the general creditors which the bankruptcy trustee asked the bankruptcy court to approve, was the bankruptcy court, in evaluating the strength of the bondholders' equitable subordination claims against the banks, required, as a matter of law, to regard the bank claimants as being covered by the "inherent fairness" doctrine of Pepper v. Litton, supra, and other cases, * under which a bankruptcy court imposes upon an "inside creditor" whose transactions with the bankrupt before bankruptcy are challenged by other creditors seeking equitable subordination the burden of proving by "clear and convincing evidence" that every transaction engaged in to the detriment of the other creditors was "inherently fair" to them?

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* Geddes v. Annaconda Copper Mining Co., 254 U.S. 590, 599 (1921); In re Midtown Produce Terminal, Inc., 599 F.2d 389 (10th Cir. 1979); Matter of Multiponics, 622 F.2d 709, 717, 720, n. 11 (5th Cir. 1980); In re American Lumber Co., 5 B.R. 470 (D. Minn. 1980).

LIST OF ALL PARTIES TO THIS PROCEEDING

Parties listed in the caption. Jay Miller and Eileen McGinnis, additional appellants below. Robert B. Yates, Jacob and Effie Norvell, Patricia L. Weideman, Charles Hooten, Marvella Associates, Ellis and Irene Beem, Drucilla H. Cooper, Joseph and Brigida Granito, Ruth Lowell, Daniel R. Taylor, John A. Taylor, Alexander and Barry Borden, Elizabeth Lane, Joseph Friedman, Richard and Virginia Adams, R. Anthony Adams, Lela and John Coonfield, intervenors-appellants below. James Stephan, Paul C. Van Kirk, Jr. (as Trustee), Bernice L. Yeracaris, Milton A. Levenfeld, IWL Partnership, Hardware Trusts Partnership, BHS Partnership and IWL-FW Partnership, intervenors-appellants below. United States Trust Company of New York, as Indenture Trustee, intervenor-appellee below. John Masse, et al., intervenors-appellees below.

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PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Petitioners respectfully pray that a writ of certiorari issue to the United States Court of Appeals for the Second Circuit for the reasons set forth below.

DECISIONS OF THE COURTS BELOW

See appendix. The opinion of the circuit court is reported at 699 F.2d 599. The opinion of the district court is reported at 20 B.R. 186. Related decisions by the bankruptcy court are reported at 4 B.R. 53 and 4 Bankr. Ct. Dec. 597.

TIME PERIODS INVOLVED

The decision of the Second Circuit of which review is sought was filed on January 26, 1983. Petitions for rehearing and for in banc reconsideration were filed by petitioners and denied by the circuit court in an order dated and filed on March 8, 1983 (see appendix). This petition was filed within 90 days after entry of the order below denying petitioners' motion for rehearing.

JURISDICTION OF THIS COURT TO HEAR THIS PETITION

This Court's jurisdiction is invoked under 28 U.S.C. §1254(1).

STATUTES, RULES AND OTHER MATTERS INVOLVED IN THIS PETITION

None.

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Set forth above.

STATEMENT OF THE CASE

Petitioners pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit entered in this case on January 26, 1983. Petitioners' motion for rehearing was denied by order dated March 8, 1983. In its opinion below, the circuit court affirmed a decision by the district court (S.D.N.Y., K. T. Duffy, J.) entered on March 16, 1982, in which the district court affirmed a decision

by the bankruptcy court (Galgay, J.) entered on June 23, 1981, which approved, pursuant to Section 27 of the Bankruptcy Act (11 U.S.C. §50), a so-called Amended Offer of Settlement which a group of 26 bank creditors (the "bank claimants") of the bankrupt W.T. Grant Company ("Grant") proposed to make to certain Grant bondholders.

<u>The Grant Bankruptcy Proceedings</u>

The Grant bankruptcy proceedings began with the filing of an arrangement petition under Chapter XI of the Bankruptcy Act on 10-2-75. Those proceedings resulted in the largest bankruptcy liquidation proceeding in the history of the federal courts. Grant was adjudicated a bankrupt on 4-13-76. After that, the Grant bankruptcy trustee, Charles G. Rodman, collected over $700 million in the estate from the sale of Grant's assets.

<u>The Amended Offer</u>

The Amended Offer is a proposed settlement offer by a group of 26 bank claimants to the holders of certain Grant debentures for the purpose of resolving certain claims made (in the context of an adversary proceeding before the bankruptcy court) by the bondholders in which the bondholders sought "equitable subordination" against the banks and challenged the validity of (a) $657 million in claims filed by the bank claimants and (b) liens held by

the banks covering the loans reflected in the banks' claims. The bondholders contended that the equity doctrine of equitable subordination should be applied (1) to the banks' liens and (2) to the banks' argument that their $657 million in claims should have priority status over the bondholders' $93.34 million in claims because the bank claims represent "Senior Indebtedness" as that term is used in the trust indenture covering the Grant 4.75% Subordinated Debentures. (See Second Circuit opinion, App. B, n. 6.)

Relief Sought

The relief sought by the bondholders was that the banks' claims be equitably subordinated by order of the bankruptcy court to a position either equal to or subordinate to the bondholders' claims. If the bank claims are held to be "senior" to those of the bondholders, the bondholders will take nothing from the estate. If the bank claims are given a status equal to the bondholders, the bondholders will be paid nearly 60 cents on the dollar for their claims. If the bank claims are subordinated to a position below that of the bondholders, the bondholders will be paid in full.

The Bondholders' Legal Theory Regarding Their Claim for Equitable Subordination

The legal theory of the bondholders' equitable subordination claim has several parts.

First, the bondholders maintain that the bank claimants owed fiduciary duties to the bondholders for a number of different reasons:

(1) The bank claimants were "inside creditors" who exercised effective control over the financial decisions of the Grant board of directors. Their status as "inside creditors" arose from the fact that the 26 bank claimants acted through three "lead banks" (Morgan Guaranty Trust Company of New York ["Morgan"], Chase Manhattan Bank, N.A. ["Chase"], and Citibank, N.A. ["Citibank"]), with Morgan acting as "agent" for all 26 banks, and Morgan had a representative on Grant's Board of Directors, its Executive Committee and its Audit Committee in the person of Dewitt Peterkin, Vice Chairman of the Morgan bank, who acted as a dominant or controlling force on the Grant board. In addition to Peterkin, the banks were also represented on the Grant board by an officer of Wilmington Trust, one of the bank claimants.

(2) By virtue of having an "inside" position of confidence and great influence or control over financial decisions of the Grant board affecting their interests, the bank claimants had the same fiduciary duties that all of Grant's officers and directors had to its stockholders and creditors once it became known (in June of 1974) that Grant was insolvent and probably headed for bankruptcy.

(3) Chase was indenture trustee for the Grant 4.75% Subordinated Debentures from their issuance until 8-14-74, when it resigned its trusteeship in favor of United States Trust Company as its successor.

(4) Citibank has been indenture trustee for the $800,000 issue of Grant 4% bonds from their issuance to the present date.

(5) Since the bank claimants acted in concert through Morgan as their "agent" and Morgan, Chase and Citibank as the "lead banks," any tortious acts done against the bondholders' interests in violation of fiduciary duties owed by Morgan, Chase or Citibank were committed by all of the banks acting in coordination or conspiracy.

(6) Under controlling principles of law or equity applicable in bankruptcy proceedings where the doctrine of equitable subordination is sought to be invoked, a heavy burden is placed upon a fiduciary who has engaged in transactions with the bankrupt before the bankruptcy proceedings that provided him with an advantage over other creditors to prove, by "clear and convincing evidence," that every such transaction was "inherently fair" to the other creditors who were not in a position to take advantage of inside information, influence or control over management. Pepper v. Litton, supra, Geddes v. Anaconda, supra, Taylor v. Stan-

dard Gas & El. Co., 306 U.S. 307 (1939); In re Midtown Produce Terminal, Inc., 599 F.2d 389 (10th Cir. 1979); Matter of Multiponics, Inc., 622 F.2d 709, 716-722 (5th Cir. 1980); In re American Lumber Co., 5 B.R. 470 (D. Minn. 1980).

(7) The bank claimants did engage in transactions with Grant prior to its bankruptcy filing that benefited the banks at the expense of the bondholders and prevented the bondholders from being offered $300 per bond for their debentures in July or August of 1974. In July of 1974, three representatives of the banks (Snyder, an officer of Morgan; Archibald, an officer of Chase; and Roberts, an officer of Citibank) met at the offices of Morgan with Pierson, President of Grant, and told Pierson that they would not allow Grant to proceed with a transaction which the Grant board had previously approved whereby Grant would reduce its crushing annual burden of debt service to the bondholders (and thereby improve cash flow) by selling certain accounts receivable for $73 million and using part of the cash proceeds to buy the 4.75% and 4% bonds on the open market for around $300 per $1,000 bond. This transaction would clearly have been advantageous to the bondholders (who have not received interest payments since 10-2-75 and who are only offered $190 per bond in the Amended Offer) and, according to an admission made by Peterkin of Morgan to Pierson

of Grant at the time (Pierson dep. at 300-306, 389-391) the transaction would have been advantageous to Grant as well. But Peterkin used his inside position and the banks' control over Grant at the Grant board meeting on 7-23-74 to veto the proposed transaction because, however detrimental the veto might be to the interests of Grant or the bondholders, the banks wanted the accounts receivable to remain assets of Grant until the banks had completed a proposed loan agreement with Grant which would subject the accounts receivable to bank liens and thus make it impossible for Grant to sell them thereafter without permission from the banks.

(8) The proposed loan transaction mentioned by Peterkin at the Grant board meeting on 7-23-74 as one of the reasons for the banks' veto of the sale of accounts and purchase of debentures was intended to improve the legal position of the banks at the expense of other general creditors (and the bondholders in particular) by making Grant, for the first time, a guarantor of over $415 million in loans made by the banks to "Grant Financial" (a separate but related corporation) and thereby elevating those loans (plus additional loans made for much smaller amounts to keep Grant afloat and away from bankruptcy for at least four months) to "senior debt" status under the trust indenture covering the bonds. A second advantage

sought by the banks was that of making all of their loans ($415 million in previous loans to Grant Financial plus new loans) subject to liens covering virtually all of Grant's assets, including its accounts receivable. To obtain the benefits of the Grant guarantee and the liens covering loans of over $400 million which Morgan, Chase and Citibank had unwisely made earlier to Grant Financial on an unsecured basis, those three "lead" banks put up relatively little "new money" in additional loans. Most of the new money lent to Grant would be provided by 116 other banks brought into the shaky Grant situation by Morgan without telling them how bad the situation actually was.

(9) The 1974 loan agreement (with the Grant guarantee and the liens built in) was negotiated by the lead banks while Chase was still indenture trustee for the 4.75% bonds, Citibank was indenture trustee for the 4% bonds, and Morgan and Wilmington Trust were still represented by influential members of the Grant board. A draft of the loan agreement was presented to the Grant board on 7-23-74, indicating that the basic terms had been agreed-upon before that time and that closing the transaction was simply a matter of the banks preparing the necessary documents for execution. That was 22 days before Chase resigned as indenture trustee in favor of U.S. Trust.

(10) The 1979 loan agreement was executed in two stages: an Interim Security Agree-

ment executed on 8-21-74 and an Initial Security Agreement executed on 10-8-74 but dated "as of" 9-16-74. Under the Interim Agreement of 8-21-74, Grant gave guarantees and liens to the banks covering $44 million in new loans. Under the Initial Agreement of 10-8-74, Grant extended those guarantees to cover a total of $600 million in loans, of which most was prior debt and not "new money" and all of which was secured by liens covering specified assets of Grant. Chase, Morgan and Citibank arranged for the Grant guarantees and liens to cover $90 million in loans each, of which $10 million each represented "new loans" and $80 million represented previous loans made to Grant Financial on an unsecured and unguaranteed basis.

(11) The acts of the lead banks whereby they (a) deprived the bondholders of an opportunity to sell their bonds to Grant at 30 cents on the dollar and (b) did so in order that they might obtain guarantees and liens on the Grant accounts receiveable covering $450 million in unsecured loans made only to Grant Financial (which is not involved in this or any other bankruptcy proceeding) clearly constituted equitable torts upon the Grant bondholders because, by those acts, the banks sought and obtained advantages over the bondholders in the event that the seriously contemplated bankruptcy proceedings should become reality. This con-

duct was particularly tortious and unconscionable on the part of Chase because it was indenture trustee for the 4.75% bondholders until 8-14-74, a date well after the 1974 loan agreements had been arranged, except for the last details. Under well-established principles of the law of New York (which controls the relationship between Chase and the bondholders under the trust indenture), an indenture trustee has a specific duty to defer the protection of its own economic interests in favor of the interests of its bondholder beneficiaries. Dabney v. Chase Nat. Bank, supra, 196 F.2d 668, 672 (2d Cir. 1952) (opinion by Learned Hand, C.J.); U.S. Trust Co. v. First National City Bank, supra, 57 A.D. 2d 285, 296 (1st Dept. 1977), aff'd w/o opinion, 45 N.Y. 2d 869 (1978); Morris v. Cantor, 390 F. Supp. 817 (S.D.N.Y., 1975, Ward, J.).*

The Bondholders' Legal Theory Regarding the Conflict of Interests of Harvey Miller and the Firm of Weil, Gotshal & Manges as Attorneys for the Grant Estate in Connection With the Litigation Over the Status of the Banks' Claims

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* In Morris v. Cantor, as in the present case, the questioned loan transaction was negotiated by Chase with a corporation while Chase was indenture trustee for certain bondholders of the company but the loan transaction was not executed until after Chase had resigned its trusteeship. On those facts, Judge Ward held that the bondholders' complaint stated a cause of action for willful misconduct under the Trust Indenture Act of 1939. 380 F. Supp. at 824.

Petitioners, David Cosoff and Helen Finkelstein, are the co-owners of $150,000 in face amount of the Grant 4.75% Subordinated Debentures, of which $92.507 million in principal amount are outstanding. Chase was the indenture trustee for those bondholders until 8-14-74, as explained above.

On 10-2-75, Grant filed its Chapter XI petition. At that time, the banks held $657.4 million in loans, all of which were made to Grant Financial (not Grant), guaranteed by Grant and covered by liens on Grant's assets. But the liens and guarantees (except for $44 million lent on 8-21-74) were all obtained on 10-8-74, less than one year before Grant's bankruptcy filing. Therefore, to the extent that the liens and guarantees were given to cover preexisting debt of around $450 million and not "new loans" made in August of 1974, those liens and guarantees were subject to being voided by the bankruptcy court as having been provided without adequate consideration.

Beyond that, those liens and guarantees provided by Grant were subject to attack on behalf of the bondholders and other general creditors on the ground of "equitable subordination" on the theory, explained above, that, in obtaining them, the lead banks violated fiduciary duties of fairness owed by them to the bondholders and made unconscionable use of their positions as "inside creditors" and "controlling

creditors" to gain advantages over the bondholders in the event of clearly-anticipated bankruptcy proceedings.

On 7-2-76, the banks (through Morgan, as "agent") began an action in the Grant bankruptcy proceeding in the nature of an adversary proceeding seeking a declaratory judgment. The purpose of that proceeding was to enforce the liens acquired by the banks on 10-8-74. The relief sought was a declaratory judgment by the bankruptcy court giving full effect to the liens and, in effect, requiring the bankruptcy trustee to turn over to the banks all of Grant's assets covered by the liens up to the amount of the banks' claims, i.e., $657.4 million. Since the amount eventually collected by Rodman from liquidating Grant's assets was a little over $700 million, enforcement of the liens would have taken well over 90% of the assets and left only $43 million for unsecured creditors with an additional $450 million in claims.

In response to the banks' adversary proceeding, the cause of the general creditors was taken up by the bankruptcy estate represented by attorney Harvey Miller and Weil, Gotshal & Manges ("WG&M"), the law firm of which he is a member. U.S. Trust Co., as successor indenture trustee for the 4.75% bondholders filed pleadings in opposition to the banks' adversary proceedings but made no ac-

tive effort at all to litigate on behalf of the bondholders against the banks. On or about 9-24-76, Miller filed an answer containing eight defenses and counterclaims on behalf of the estate and for the benefit of the general creditors.

From about October of 1976 to around December of 1977, WG&M spent a great amount of time and effort litigating on behalf of the general creditors against the banks. They expended many thousands of attorney hours in (a) obtaining production of hundreds of thousands of pages of documents from the banks' files and (b) conducting extensive depositions ("Rule 205 examinations") of about 25 witnesses, which resulted in somewhere between 10,000 and 12,000 pages of deposition transcripts. U.S. Trust did not subpoena a single document or question a single witness. Its litigation efforts were limited to sending a junior associate to attend the Rule 205 examiantions conducted by WG&M. WG&M has been paid several million dollars as interim fees by the Grant estate for its work in conducting the litigation against the banks and a total of over $14 million to date for all of its work on the Grant case.

At some point in late 1977 or early 1978, unknown to petitioners' counsel, the discovery process ended and negotiations began of a settlement of the litigation between the banks (as

purported lien creditors and holders of "senior indebtedness" vis-a-vis the bondholders) and the estate (representing the unsecured, general creditors). The participants in those negotiations were WG&M (on behalf of Rodman), Morgan (represented by Davis, Polk & Wardwell, on behalf of the banks) and United States Trust (represented by Whitman & Ransom).*

On 4-7-78, WG&M filed on behalf of Rodman an application with the bankruptcy court for approval of a so-called "Global Settlement Agreement" by means of which the banks proposed to resolve their disputes with all of the remaining Grant creditors. That goal was not achieved, and the banks have, since 1979, referred to the resulting agreement as the "Bank Settlement Agreement." Judge Galgay approved the Global Settlement Agreement in a 46-page opinion and order dated 7-20-78 (4 Bankr. Ct. Dec. 597).

The Global Settlement Agreement was not "global" because certain parties purporting to represent the interests of the Grant 4.75% and

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* The banks settled with the Secured Suppliers in an agreement approved by the bankruptcy court on 2-3-77 and (in amended form) by the Second Circuit on 4-6-78. In late 1977, the banks made a settlement offer to the holders of Senior Debentures for whom Morgan was indenture trustee but for whom Fidelity Union bank had assumed Morgan's fiduciary duties. Rodman recommended that settlement for Bankruptcy Judge Galgay's approval, which was provided in an order dated 1-18-78. That settlement became effective as of 4-19-78.

4% bondholders would not accept the terms offered by the banks to them (at that time, less than 8 cents on the dollar). Those claiming to represent the 4.75% bondholders and refusing to accept the banks' terms were Whitman & Ransom (on behalf of U.S. Trust as indenture trustee) and attorney I.W. Bader (on behalf of Morris Lewy, Victor Kurtz and several other bondholders who called themselves the Ad Hoc Bondholders' Committee). As a consequence of that lack of consent, the banks and the estate worked out an arrangement that was incorporated into the Global Settlement Agreement and the order of 7-20-78 approving it whereby a "reserve fund" would be created in the amount of $95.378 million representing principal and interest on the 4.75% and 4% bonds ($93.341 million) plus interest to 10-2-75, the date of the Chapter XI filing.*

The banks created the idea of a reserve fund with the bankruptcy trustee as "stakeholder" of the funds in dispute between them and the bondholder interests and were enthusiastic about it in 1978 because execution and court approval of the Global Settlement Agreement made possible a prompt payout by the estate to

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* This fund was held unsegregated by the Grant estate as part of its assets and invested in such a way that interest was accumulated on it at the rate of about 10.5% per year which was, in effect, "compounded" every six months by the purchase of new certificates of deposit.

the banks of several hundred million dollars* which the banks were then extremely interested in getting as soon as possible. At that time, the banks probably thought that a settlement with the bondholder representatives would be possible within a few weeks or months and no later than the end of 1978. No such prompt settlement was reached.

In motion papers filed in April 1978 in support of Rodman's application for approval of the Global Settlement, WG&M advised Bankruptcy Judge Galgay that a case could be proven with evidence then available for applying the remedy of equitable subordination against the banks for the purpose of invalidating the liens obtained on 8-21-74 and 10-8-74. At the time, Judge Galgay apparently accepted that assessment of the factual case and applicable law at face value.

Later, in April of 1979, when WG&M sought to justify their recommendation that the bankruptcy court approve the proposed Original Offer of settlement by the banks to the bondholders of 14 cents on the dollar (with 1% or $950,000 allowed to Whitman & Ransom as legal fees), it became tactically necessary for them to abandon their earlier opinion that the case for equitable subordination is very strong and take the

* The exact amount is unknown to petitioners' counsel but is estimated to have been between $250 million and $300 million.

opposite view, i.e., that equitable subordination would be extremely difficult to establish because the available evidence is very weak and the applicable case law requires that a claimant seeking the remedy of equitable subordination has a "very substantial" burden of proof and contractual subordination provisions are enforced under "well-established" case law in the Second Circuit even in cases where the unsubordinated creditors had committed outright fraud upon the contractually subordinated creditors.

This was a complete distortion by counsel for the estate of the available facts and a totally incorrect description of applicable principles of law in the area of equitable subordination. But WG&M apparently regarded this total reversal of its earlier opinion of the case to be necessary in order to support its argument that the Original Offer of 14% to the bondholders was extremely favorable in the circumstances and the best that could possibly be obtained from the banks without additional protracted litigation beyond the 8,000-plus hours already devoted by WG&M attorneys to the litigation.*

On behalf of U.S. Trust as indenture

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* As far as the record discloses, Judge Galgay perceived no significant inconsistency between the positive assessment of the case for equitable subordination presented to him by WG&M in April of 1978 and the negative assessment submitted to him by the same firm one year later.

trustee, Whitman & Ransom recommended that Judge Galgay approve the Original Offer of 14% to the bondholders with $950,000 allowed for the payment of U.S. Trust's attorneys' fees to Whitman & Ransom. Whitman & Ransom also agreed completely with the negative assessment of the equitable subordination claim provided by WG&M on behalf of Rodman, conveniently ignoring the earlier positive assessment by Rodman's attorneys.

The bondholders represented by attorney I.W. Bader (now joined by attorney Bradley R. Brewer as co-counsel) opposed the Original Offer as inadequate because it did not reflect the true strength of the equitable subordination claim on the facts and the law. They agreed with Rodman's original assessment.

Between the bankruptcy court opinion of 7-20-78 approving the Global Settlement and 4-18-79, there were prolonged settlement negotiations leading toward the Original Offer of 14% but no efforts by the estate or U.S. Trust to litigate the bondholders' claims against the banks. On 4-18-79, WG&M filed on behalf of Rodman an application for bankruptcy court approval of the Original Offer by the banks. By this time, the only creditors remaining in the Grant estate with claims at odds with those of the banks were the bondholders.

One of Bader's bondholder clients, Victor Kurtz, retained attorney Morton Robson to

represent him. At the insistence of Judge Galgay, Robson was allowed to appear as co-counsel with Bader for Kurtz. Bader and Brewer remained as co-counsel for Bader's other clients. Brewer was retained by bondholders Cosoff and Finkelstein to represent them as sole counsel.

Attorneys Robson, Bader and Brewer joined forces to oppose the application for approval of the Original Offer. Hearings were held before Judge Galgay on five days between 5-22-79 and 6-19-79.* On 2-20-80, Judge Galgay filed an opinion and order approving the Original Offer. The objectants took an appeal that was assigned to District Judge William Conner and briefed by May of 1980.

By October of 1980, it became evident that Judge Conner might take another year to decide the appeal, and 18 months had already passed since the Original Offer had been presented to Judge Galgay on 4-18-79. The reserve fund of $95 million had accumulated over $15 million in interest, an amount equal to the entire amount of the Original Offer. Bondholders supporting the objectants' opposition to the Original Offer had grown from around 2% at the time of the hearings in May of 1979 to over 30%, and the number was increasing.

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* The objectants were allowed only 14 days to conduct discovery. During that time, neither Peterkin of Morgan nor any of the significant witnesses from Chase were available to testify.

The banks then decided to withdraw the Original Offer and replace it with an Amended Offer of 19% with 2% (or $1.9 million) allowed for the payment of attorneys' fees to Whitman & Ransom, Robson, Bader and Brewer.

Robson decided to accept the Amended Offer and persuaded Kurtz to do so. Most of Bader's clients decided to accept the offer, and Bader elected to represent them, despite his personal conviction that the offer was inadequate. Brewer agreed to represent any bondholder who might wish to oppose Rodman's application for approval of the Amended Offer. Petitioners Cosoff and Finkelstein retained him for that purpose on 6-13-81. Judge Galgay held a supplemental hearing on 6-16-81 on the application for approval of the Amended Offer and approved that offer in an order dated 6-23-81. Petitioners appealed to the district court and lost in a decision by Judge K.T. Duffy dated 3-15-82, 20 B.R. 186. Petitioners appealed to the Second Circuit and lost in the decision which they now ask this Court to review and reverse.

Petitioners maintain that there is a reason why attorney Miller and his firm abandoned their earlier positive assessment of the case for equitable subordination and agreed promptly to the Original Settlement Offer by the banks of 14% as soon as it was made and joined forces with the banks and U.S. Trust

in recommending that Judge Galgay approve it as fair and a reasonable reflection of the bondholders' chances of succeeeding on the equitable subordination claim.

Attorney Miller was selected by counsel for the banks to be recommended to Charles Rodman, the bankruptcy trustee, and to the bankruptcy court for appointment as counsel for the Grant estate. Rodman was also selected and recommended for the job of trustee by counsel for the banks. Miller represented the bank creditors as secured creditors before the official creditors' committee was formed. When that committee was formed, Miller was selected as one of its co-counsel (representing the banks' interests) and another attorney (who had previously represented trade creditors) was selected as the other co-counsel. Miller represented the banks' interests on the creditors' committee for a period of six months, until the bankruptcy adjudication on 4-13-76. Soon thereafter, the banks recommended Rodman to be bankruptcy trustee and Miller to be his attorney, and the bankruptcy court entered orders appointing both of them.

When Rodman and Miller were appointed to their posts, brief hearings were held before Judge Galgay. Rodman disclosed the circumstances involved in his selection by counsel for Chase first to serve as standby trustee during the Chapter XI period and then to be bankruptcy

trustee after 4-13-76. Miller made limited, but not complete, disclosure of his prior relationship with the bank claimants, and Judge Galgay was familiar with his service as co-counsel for the official creditors' committee. At that time and thereafter, Miller and WG&M were actively representing certain of the bank creditors in other and unrelated bankruptcy cases for which they received substantial fees. Those circumstances and the obvious conflict of interests created by them were not fully or adequately brought to the attention of the bankruptcy judge.

Specifically, two important things were not brought to Judge Galgay's attention in April of 1976, either by Miller or by counsel for the banks, although they were well aware of them. First, Miller had previously represented the banks in connection with the Grant bankruptcy proceeding itself and was continuing to represent them in other matters. The banks were not general creditors but lien or <u>secured</u> creditors. It has long been the law in bankruptcy proceedings that an attorney who had previously represented <u>secured</u> creditors cannot be appointed counsel for the bankrupt estate because the administration of the estate is conducted primarily, if not exclusively, for the benefit of unsecured creditors, and the interests of secured and unsecured creditors are inherently in conflict. In par-

ticular, an attorney who has previously represented a secured creditor should not become counsel for a bankrupt estate where it is known that the security interest of the former client will be challenged in the bankruptcy proceeding. This Court expressly recognized these long-established principles in one of the most-often cited bankruptcy cases of all time, Pepper v. Litton, supra, decided in 1939. 308 U.S. 295 at 300.

The applicable rule of law and the relevant holding of Pepper v. Litton were not brought to Judge Galgay's attention in April of 1976. Section 44(c) of the Bankruptcy Act provides that:

> "An attorney shall not be disqualified to act as an attorney for the receiver or Trustee merely by reason of his representation of a general creditor." (Emphasis supplied.)

Judge Galgay was familiar with that provision. It is quite common for an attorney who has previously represented a major general creditor to become counsel for a bankrupt estate, but uncommon (and improper) for an attorney who has previously represented a secured creditor to be so appointed. Apparently, but most unfortunately, Judge Galgay simply failed to note the distinction and its significance for the purposes of Miller's appointment.

The bankruptcy court's misinterpretation of the law in this connection is under-

standable (but no less erroneous) because of the second important thing that Miller and the banks failed to disclose at the appointment hearing in April of 1976. They did not tell Judge Galgay that there was certain to be massive and prolonged litigation between the interests of the general creditors and those of the banks over the validity of the banks' liens and guarantees from Grant and that one of the main tasks of the estate's attorney would be to litigate against the banks with hundreds or millions of dollars at stake. At that time, they knew that, and knew it perfectly well, but no one else did.

Because of the circumstances described above and many others,* a clear-cut and most

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* Between 10-2-75 and 10-9-75, Miller received a telephone call from Charles Hoppin, a partner of Davis, Polk & Wardwell, attorneys for Morgan as leader of (or "agent" for) the bank claimants. (Transcript of hearings before Judge Galgay in 1979, p. 584.) Mr. Hoppin told Mr. Miller that the Grant bank creditors wanted him to represent them in connection with the formation of a creditors' committee or "bank committee" in the Grant proceedings.

On 10-9-75, Miller met with Hoppin and other Davis Polk attorneys and began to advise them about the procedures involved in Chapter XI arrangements and what steps are usually taken by the two groups of creditors normally represented by counsel (i.e., the bank creditors and trade creditors) at the first (and informal) meeting of creditors. Among other things, he discussed what "indemnity" is and how the major creditors normally go about establishing a creditors' committee.

Among other things, Miller inquired about the nature of the banks' claims and asked who the banks other than

(footnote continued on next page)

appalling conflict of interest situation was created and the appearance of impropriety was inescapably generated, which neither Rodman

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(Footnote continued from previous page:)

Morgan were. In response, Hoppin told Miller that the banks were secured creditors of Grant under an agreement created some time before. This knowledge on the part of Miller as early as 10-9-75 that the banks claimed to have valid and enforceable liens on Grant's assets is extremely important for appellants' conflict-of-interest argument against Miller and his firm, because it means that Miller, a specialist in bankruptcy law who teaches that subject in a major law school and frequently lectures on the subject to practicing attorneys, knew that under the bankruptcy rules, he could not be engaged to represent secured creditors in a bankruptcy proceeding and then later be appointed to act as attorney on behalf of the estate for general creditors.

Since (a) the task of a bankruptcy trustee and his attorney is to gather and distribute the estate for the benefit of general creditors and (b) that task imposes upon both of them the duty to examine carefully all security claims and to challenge in court those of doubtful validity, the rules applicable in bankruptcy proceedings have long prevented an attorney who begins his involvement with a bankruptcy proceeding by representing secured creditors from later acting as counsel for the estate and thereby assuming responsibilities potentially antagonistic to his former clients. If it were not so, an attorney might be engaged by certain creditors to draft documents creating certain security interests and then later be engaged by the estate to attack by litigation the validity of the documents that he himself drafted.

On 10-15-75, Miller, as attorney for a committee of bank creditors, attended a Grant creditors' meeting at the Americana Hotel in Manhattan. (Tr. 614) He told those present that he was representing the bank creditors. (Tr. 616) Before that meeting began, Mr. Miller had lunch with an officer of Citibank named Ingram and several other people representing the banks. Mr. Ingram had been designated by the bank claimants to act as chairman of the creditors' meeting.

The purpose of that luncheon meeting clearly was for

(footnote continued on next page)

(himself an attorney) nor Miller did anything at all to correct. See, In re Eastern Sugar Antitrust Litigation, 697 F.2d 524 (3d Cir. 1982).

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Miller to advise Ingram and the others present concerning what steps should be taken at the creditors' meeting according to applicable law and common practice. Others present at the meeting were a bank officer from Morgan and several attorneys from the Davis Polk firm representing Morgan. Only representatives of the bank creditors, Mr. Miller's clients, were present at the 10-15-75 luncheon meeting.

At the 10-15-75 luncheon meeting, Mr. Miller discussed with those present: (1) the size of the creditors' committee, (2) which bank creditors would place members on that committee, and (3) the question of Mr. Miller being retained as attorney for the creditors' committee after its formation.

At the 10-15-75 creditors' meeting, there was a discussion of the size and composition of the creditors' committee. It was decided that the committee would have 11 members, with 6 members representing the banks and 5 representing other creditors.

Mr. Ingram encountered difficulty in maintaining control of the proceedings. When that happened, Ingram called on Mr. Miller as his counsel to assist in maintaining order at the meeting. In this way, Mr. Miller was identified by Mr. Ingram to all present as an attorney for the bank creditor group.

Once the creditors' committee was formed and the identities of its members determined, the committee met in closed session (only members present) and retained as co-counsel for the committee Mr. Miller's firm (which had represented the banks at the earlier meeting) and Ballon, Stoll & Itzler (which had represented a large group of trade creditors at the preceding meeting). At the luncheon meeting, Miller had told the bank representatives that he had been contacted earlier by the Ballon firm and told that the Ballon firm would be representing trade creditors at the creditors' meeting.

It is common practice in bankruptcy proceedings to have trade creditors and bank creditors dominate and control the first meeting of creditors and for the

(footnote continued on next page)

Based upon those known circumstances, petitioners believe that Miller and WG&M simply capitulated to the banks when the banks proposed the Original Settlement because they and Rodman were deeply beholden to the banks for getting them their respective appointments. Miller's firm has billed the Grant estate somewhere between $15 and $20 million for services in the Grant matter, and Rodman has been paid $250,000 per year to act as bankruptcy trustee. Neither of them could afford to anger the banks by opposing the Original Offer, and, not surprisingly, neither of them did.

Of course, it may be that Rodman, Miller

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attorneys for those groups to be designated attorneys for the creditors' committee upon its formation. Here the trade creditors and bank claimants had potentially conflicting interests arising from the Inventory Security Agreement of 5-15-75 and related circumstances. Both groups (trade and bank creditors) claimed liens.

No explanation was ever provided by U.S. Trust as to why it did not seek a place on the creditors' committee for the $92.5 million in claims against the Grant estate held by the bondholders for whom it acted as indenture trustee.

Despite the foregoing circumstances, Mr. Miller claimed, during the hearings before Judge Galgay on the Original Offer, that he never learned or had any idea why his firm and the Ballon firm were appointed co-counsel for the creditors' committee. This testimony was disingenuous because it was clear that the Weil Gotshal & Manges firm had been designated because it was counsel for the banks and the Ballon firm had been designated because it was counsel for the trade creditors. The only general creditors represented on the creditors' committee were trade creditors without liens.

and the other attorneys involved at WG&M actually acted in utmost good faith and sincerity when they tailored an argument in support of their recommendation of the Original Settlement to the bankruptcy court in 1979 that was completely inconsistent with what they told Judge Galgay in writing in 1978. But the appearances to the contrary are obvious and disgraceful. Almost any layman informed of these circumstances would be shocked and scandalized.

Petitioners maintain that Miller was manifestly unqualified to be appointed or to act as attorney for the Grant estate at all and should never have been appointed to that position. When it became evident that the estate would have to conduct massive litigation against the banks involving high stakes, Miller and his firm should have resigned as counsel for the estate. Failing to do that, Miller, his firm and Rodman should at least have appointed a totally independent firm of attorneys to litigate against the banks and dissociated themselves completely from any involvement in that controversy. If that had been done, the appearance of conflicting interests and impropriety would have remained but in a substantially less virulent form. As soon as the banks' adversary proceeding was commenced and the apparent conflict of interests became known, Miller should have brought the entire problem before the bankruptcy court

for an open hearing and ruling on the propriety and legality of his conduct. He and his firm have only themselves to blame for their failure to do so.

In response to this argument and to petitioners' contention that (1) Miller and WG&M were unqualified either to litigate against the banks on behalf of the bondholders or to present an objective evaluation of either the Original Settlement or the Amended Settlement to the bankruptcy court pursuant to §27 of the Bankruptcy Act and (2) the bankruptcy court's approval of the Amended Offer was fatally flawed by that court's failure to appoint an independent attorney to investigate the bondholders' claims and present an untainted opinion and recommendation, the Second Circuit below refused to "find that any of the relationships charged by appellants were disqualifying" and that the facts regarding Miller's earlier representation of the banks in connection with the Grant bankruptcy were limited to only five days of actual, formal representation and were, therefore, in the judgment of the panel, "*de minimis*." Petitioners most strenuously disagree, and they urge this Court to do so as well by granting the requested writ and subjecting the decision and record below to a most searching review.

Petitioners submit that the circuit court panel below applied the wrong standard of judg-

ment to the obvious conflict of interest problem involved in this case. As the Third Circuit recently pointed out in the Eastern Sugar case, supra, the proper test where a conflict of interest is perceived on the part of an attorney acting by court appointment in a fiduciary capacity on behalf of thousands of persons not represented by their own counsel is not whether the circumstances are shocking to the minds of three case-hardened federal judges with years of experience in observing instances of dishonest behavior but rather whether the circumstances would be shocking to an average layman informed of them.

What the average layman would think about the conflict of interest problem in this case is obvious. He would be shocked and disappointed at the behavior of Mr. Miller and shocked even more by the decision of the Second Circuit on this point. If you don't believe it, find one and ask him.

REASONS WHY THIS PETITION SHOULD BE GRANTED AND ARGUMENT

See discussion above.

CONCLUSION

For the reasons set forth above, this petition for a writ of certiorari should be granted.

Respectfully submitted,
Bradley R Brewer
BRADLEY R. BREWER
Attorney for Petitioners
799 Broadway, New York, N.Y.
(212) 777-4010

A P P E N D I X

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse, in the City of New York, on the eighth day of March, one thousand nine hundred and eighty three.

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IN RE

W.T. GRANT COMPANY, No. 82-5019
5023

Bankrupt.

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A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for appellants, David Cosoff and Helen Finkelstein.

UPON CONSIDERATION by the panel that heard the appeal, it is

ORDERED that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge on the panel

that heard the appeal and that no such judge has requested that a vote be taken thereon.

A. Daniel Fusaro, Clerk

by Francis X. Gindhart,
Chief Deputy Clerk

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 381—August Term, 1982

(Argued November 19, 1982 Decided January 26, 1983)

Docket Nos. 82-5019, 82-5023

IN RE:

W. T. GRANT COMPANY,

Bankrupt,

DAVID COSOFF and HELEN FINKELSTEIN,

—and—

JAY MILLER and EILEEN MCGINNIS,

Appellants,

—v.—

CHARLES G. RODMAN, as Trustee of W.T. GRANT COMPANY, Bankrupt,

Appellee,

ROBERT B. YATES, JACOB AND EFFIE NORVELL, PATRICIA L. WIEDEMAN, CHARLES HOOTEN, MARVELLA ASSOCIATES, ELLIS AND IRENE BEEM, DRUCILLA H. COOPER, JOSEPH AND BRIGIDA GRANITO, RUTH LOWELL, DANIEL R. TAYLOR, JOHN A. TAYLOR, ALEXANDER AND

BARRY BORDEN, ELIZABETH LANE, JOSEPH FRIEDMAN, RICHARD AND VIRGINIA ADAMS, R. ANTHONY ADAMS, and LELA AND JOHN COONFIELD,

Intervenors-Appellants,

JAMES STEPHAN, PAUL C. VAN KIRK, JR. (as Trustee), BERNICE L. YERACARIS, CONSTANTINE A. YERACARIS, MILTON A. LEVENFELD, IWL PARTNERSHIP, HARDWARE TRUSTS PARTNERSHIP, BHS PARTNERSHIP, and IWL-FW PARTNERSHIP,

Intervenors-Appellants,

UNITED STATES TRUST COMPANY OF NEW YORK, as Indenture Trustee,

Intervenor-Appellee,

JOHN MASSE, et al.,

Intervenors-Appellees.

Before:

WATERMAN, FRIENDLY and MESKILL,
Circuit Judges.

Appeals by holders of 4¾% subordinated debentures of W.T. Grant Co. from an order of the District Court for

the Southern District of New York, Kevin Thomas Duffy, *Judge*, 20 B.R. 186 (1982), approving the proposal by Grant's bankruptcy trustee of a settlement between the debentureholders and the bankrupt estate. Affirmed.

BRADLEY R. BREWER, New York, NY (Brewer & Soiero, New York, NY), *for Appellants Cosoff and Finkelstein*

STUART A. JACKSON, New York, NY, *for Appellants Miller and McGinnis*

HARVEY D. MILLER, New York, NY (Weil, Gotshal & Manges, New York, NY), *for Appellee Rodman as Trustee*

JAMES C. SARGENT, New York, NY (Whitman & Ransom, New York, NY), *for Intervenor United States Trust Company of New York*

I. WALTON BADER, White Plains, NY (Bader and Bader, White Plains, NY), *for Intervenors Masse, et al.*

FRIENDLY, *Circuit Judge*:

These appeals arise from the mammoth bankruptcy proceedings of W.T. Grant Co. before Bankruptcy Judge Galgay in the Southern District of New York. Grant initially filed a petition for an arrangement under chapter

XI[1] on October 2, 1975, and was adjudged bankrupt on April 13, 1976. Secured suppliers, holders of senior debentures, bank creditors, general unsecured creditors, and holders of two issues of subordinated debentures filed claims against the bankrupt estate. The present appeals concern the last of a series of compromises and settlements[2] designed to avoid what would necessarily have been extremely protracted litigation with the various claimants. We shall assume familiarity with Judge Galgay's opinions and will endeavor to state only what is necessary to an understanding of these appeals.

The History of Grant's Financings

Prior to July, 1973, Grant, which operated a large chain of retail stores, generally satisfied its short-term cash needs by selling commercial paper through a wholly owned subsidiary, W.T. Grant Financial Corporation (Grant Financial); it had relatively small revocable lines of credit at several hundred banks.[3] In the spring of 1973 Grant determined that a portion of the commercial paper

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1 All references are to the Bankruptcy Act of 1898 and the Rules thereunder.

2 The earlier ones were a compromise and settlement with the secured suppliers, approved by the Bankruptcy Court on Feb. 3, 1977, *aff'd*, Docket No. 78-5010 (2 Cir., April 6, 1978); a compromise and settlement with senior debentureholders approved Jan. 18, 1978; a compromise and settlement with the bank claimants approved July 20, 1978, 4 Bankr. Ct. Dec. 597; a first order approving a compromise and settlement with the junior debentureholders dated Feb. 20, 1980, 4 B.R. 53; and a further order dated June 23, 1981, approving a revised form of this settlement, from which the appeals here at issue were taken.

3 For example, as of Jan. 31, 1973, Grant had only $10,000,000 in bank debt, all of it short term, as against $380,033,500 in outstanding commercial paper.

outstanding should be converted into long-term debt and approached Morgan Guaranty Trust Co. of New York (Morgan Guaranty) to structure a $100,000,000 five year term loan. On July 5, 1973, Morgan Guaranty arranged such a loan to Grant Financial from eight banks replacing an equivalent amount in their lines of credit to Grant. Among these banks were, in addition to Morgan Guaranty, Chase Manhattan Bank, N.A. (Chase), which was the trustee under an indenture under which $92,507,000 of Grant's 4¾% unsecured subordinated debentures issued April 15, 1971, were outstanding as of the date of filing under Chapter XI, and First National City Bank, now Citibank, N.A. (Citibank), which was trustee under an indenture under which $834,000 of Grant's 4% unsecured subordinated debentures issued June 1, 1965, were outstanding as of the date of filing under Chapter XI.

Grant's financial performance declined during 1973 and in December Moody's and Standard and Poor's lowered Grant Financial's commercial paper ratings from prime 1 to prime 2 and also downgraded Grant's long-term securities. Grant resorted to borrowing under its lines of credit. On March 5, 1974, Moody's withdrew Grant Financial's commercial paper rating and further downgraded Grant's long-term securities. Faced with the need to raise more than $132,000,000 in order to meet commercial paper maturities in the next week, Grant asked the eight banks to reestablish their lines of credit. They did this in proportion to their prior exposure, with the result that their loans and advances to Grant Financial shortly reached $415,000,000. Even this borrowing was not enough; in August, 1974, Morgan Guaranty, Chase and Citibank each advanced an additional $5,000,000 to Grant (Secured Demand Loans) secured by an assignment of certain accounts receivable. Later in August, 1974,

Grant Financial, Grant as guarantor, and eleven bank lenders entered into an Interim Loan and Guaranty Agreement wherein Grant Financial became indebted to the eleven banks in the aggregate amount of $44,000,000 by assuming Grant's obligation to repay the $15,000,000 of Secured Demand Loans just described and incurring New Loans of $29,000,000, all such loans being guaranteed by Grant and secured under an Interim Security Agreement dated as of August 21, 1974, by accounts receivable arising out of the sale of goods at designated stores. This brought the total short-term and long-term loans from Grant's 12 major bank lenders to approximately $517,000,000.

The Interim Loan and Guaranty Agreement was shortly succeeded by a Loan and Guaranty Agreement dated as of September 16, 1974, which became effective October 8, 1974, less than a year before Grant filed under Chapter XI. The parties were Grant Financial, Grant as guarantor, and 143 banks. The maturity of all outstanding short-term unsecured loans and the $44,000,000 of secured loans under the Interim Agreement was extended through June 2, 1975, and the banks agreed to increase their loans to $600,000,000. The obligations of Grant Financial were to be guaranteed by Grant. An Initial Security agreement dated September 16, 1974, secured the $600,000,000 total of outstanding short-term loans and future commitments under the Loan and Guaranty Agreement and the $100,000,000 long-term notes issued under the Term Loan Agreement of July, 1973.[4] On the

[4] The security was to consist of all of Grant's customer accounts receivable and the securities of Zeller's Ltd., a Canadian subsidiary of Grant. The security was pledged ratably for the benefit of $23,995,000 of Grant's 4¾% senior sinking fund debentures. All financing statements required to perfect security interests under the Initial Security Agreement were timely filed by Morgan Guaranty as agent.

date when the Loan and Guaranty Agreement became effective, the banks advanced an additional $66,587,500, thereby reaching the $600,000,000 in loans due June 2, 1975, contemplated by the agreement, plus the $100,000,000 represented by the July, 1973, Term Loan Agreement. As of April 1, 1975, Grant, Grant Financial and Morgan Guaranty entered into a Loan Extension Agreement actually executed June 2, 1975, within four months of the filing of Grant's Chapter XI petition. This provided for paying off a debt of $56,931,665.59 to 116 banks whose individual loans to Grant ranged from $50,000 to $5,000,000 and the extension to March 31, 1976, of outstanding short-term loans in the principal amount of $540,916,978 made by the other banks.

Somewhat earlier Grant had been obliged, in order to induce its largest vendors and suppliers to continue providing it with credit, to enter into an Inventory Security Agreement dated as of May 15, 1975, wherein Grant gave a lien on designated store inventories to specified vendors and suppliers. Under the Loan and Guaranty Agreement, the bank claimants were to receive a lien on inventory junior to that of the suppliers and the senior debentureholders.

The final transaction was an Amended Loan Extension Agreement entered into as of August 6, 1975, which became effective on September 15, 1975. This further extended the maturity of the $540,916,978 of short-term bank loans to July 30, 1976; subordinated $300,000,000 of that debt to certain trade obligations (the "Trade Subordination Agreement"); and subordinated Grant Financial's loans of $819,887,663 to the banks' total claim of $640,916,978 (the "Intercorporate Subordination Agreement").

The Proceedings in the Bankruptcy Court and the District Court

After Grant had been ordered into liquidation, the banks and Charles G. Rodman, as Trustee, asserted a multitude of claims against each other in an adversary proceeding, the details of which are described in Judge Galgay's opinion, 4 Bankr. Ct. Dec. at 601-02. The Trustee conducted an elaborate investigation into the affairs of Grant under Bankruptcy Rule 205(a). This encompassed production of the books, records and other documents of Grant, and examination of its remaining and former officers, directors and employees. Before any extensive discovery by the banks, settlement negotiations were instituted. These resulted in an agreement which, in addition to settling the claims of the banks, encompassed what Judge Galgay termed a "global settlement", i.e., a "framework for the further administration of the bankrupt estate and the satisfaction of claims filed against such estate." 4 Bankr. Ct. Dec. at 602. So far as here relevant, the settlement provided that the bank claimants were to receive an initial cash distribution of $165,700,000, or approximately 25% of their allowed claims. More was to be paid when and if funds became available. The Trustee agreed not to sue the 116 banks whose loans of $56,931,665.59 were paid in June, 1975. Finally, the agreement created a fund of $95,378,373, the full amount of the claims of subordinated debentureholders, pending resolution of their dispute with the bank claimants as to whether the subordination clauses of their indentures should be given effect so as to subordinate the debentureholders's claims to the bank claims. The Bankruptcy Judge approved the banks' settlement on July 20, 1978, finding that "[t]he Trustee will have achieved a

result for the estate which approximates, and may exceed, the results which are likely to be achieved by the continued prosecution of his defenses in the Adversary Proceeding" which the bank claimants had initiated, 4 Bankr. Ct. Dec. at 609. There was no appeal of this "global settlement" to the district court.[5]

Having thus provided the necessary framework, the Trustee, the bank claimants, United States Trust Company (U.S. Trust) as indenture trustee replacing Chase under the Indenture for the 4¾% Subordinated Debentures, and representatives of these debentureholders entered into negotiations for the settlement of the latter's claims. The rights of the debentureholders depended on the interpretation and application of a clause in their indentures subordinating their claims to "Senior Indebtedness" of Grant. The Indenture under which the 4¾% Debentures were issued defined this as stated in the margin;[6] the Indenture securing the small amount of

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[5] An "Ad Hoc Protective Committee of 4¾% Convertible Subordinated Debentures of W.T. Grant Company", including Mr. Victor Kurtz and represented by I. Walton Bader, raised objections to the banks' settlement at the hearing. The failure by Mr. Kurtz's "Protective Committee" to pursue its objections by appealing from the Bankruptcy Judge's allowance of the banks' claims forecloses some of the issues raised in the present appeal. While Judge Galgay expressly reserved "the claims of Subordinated Debentureholders purportedly represented by the Ad Hoc Protective Committee" pending subsequent determination of "the validity and enforceability of the subordination provisions contained in the Subordinated Debentures and related Trust Indentures," 4 Bankr. Ct. Dec. at 608, this reservation of claims against the bankrupt estate and, by extension, against the bank claimants, does not go still further to permit, e.g., re-opening of the question whether the Trustee properly agreed not to question the June, 1975, payments of $56,931,665.59 to the 116 other bank creditors of Grant.

[6] The term "Senior Indebtedness" shall mean the principal of and premium, if any, and interest on (a) indebtedness (other than the Debentures and the Convertible Subordinated Debentures due June

outstanding 4% Debentures was to the same effect. If the bank claims were and remained enforceable as Senior Indebtedness to which the debentureholders were subordinated, the latter would receive nothing. However, U.S. Trust alleged that for a number of reasons the conduct of the banks might require the contractual subordination provisions be disregarded and even that the subordinated debentureholders be accorded a status prior to that of the banks.[7] These reasons, stated in detail in Judge Galgay's

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1, 1990 of the Company) of the Company for money borrowed from or guaranteed to persons, firms or corporations evidenced by notes or similar obligations, (b) indebtedness of the Company evidenced by notes or debentures (other than the Debentures and the Convertible Subordinated Debentures due June 1, 1990 of the Company) issued under the provisions of an indenture or similar instrument between the Company and a bank or trust company or (c) purchase money indebtedness of the Company, in each case, whether outstanding at the date of execution of this Indenture or thereafter incurred; unless, in each case, by the terms of the instrument by which the Company incurred, assumed or guaranteed such indebtedness, it is expressly provided that such indebtedness is not superior in right of payment to the Debentures. As used in the preceding sentence the term "purchase money indebtedness" shall mean indebtedness evidenced by a note, debenture, bond or other instrument (whether or not secured by any lien or other security interest) issued or assumed as all or a part of the consideration for the acquisition of property, whether by purchase, merger, consolidation, or otherwise; *provided, however,* that such term shall not include any account payable or any other indebtedness created or assumed by the Company in the ordinary course of business in connection with the obtaining of materials or services.

[7] We reject the objectants' assumption that the doctrine of equitable subordination must invariably work to reverse the positions of senior and junior creditors. The equitable powers of the bankruptcy court are broad. *Pepper v. Litton*, 308 U.S. 295, 304-05 (1939), and it may "adjust . . . equities among the creditors" in a flexible manner. Herzog & Zweibel, The Equitable Subordination of Claims in Bankruptcy, 15 Vand. L. Rev. 83, 87 (1961). Before considering a complete reversal of priorities, the bankruptcy court would have been obliged to weigh the less drastic remedy of placing a culpable senior creditor on a plane of equality with junior creditors.

opinion approving the settlement, 4 B.R. at 60-61, were as follows:

(a) At the time of the Initial Security Agreement of September 16, 1974, the bank claimants knew or had reasonable cause to believe that Grant was insolvent and that the granting of security interests would discourage further extensions of trade credit to Grant and substantially reduce the flow of merchandise into Grant stores, thereby impairing the prospects for a successful reorganization of Grant.

(b) By forcing Grant into the Inventory Security Agreement and Trade Subordination Agreement the bank claimants increased the amount of Senior Indebtedness to which the junior debentureholders were subordinated.

(c) In the summer of 1974, the bank claimants directed Grant not to proceed with a proposed sale of $100,000,000 of customer accounts receivable to Beneficial Finance Corporation and the use of some undetermined portion of the proceeds to purchase 4¾% debentures at 25 cents on the dollar.

(d) The bank claimants used their position of control over Grant's management to prevent Grant from promptly seeking relief under the Bankruptcy Act, feeding it just enough money to keep its head above water while strengthening their security position, allowing the passage of the four months period for avoiding preferences under § 60a and hoping to allow the passage of the one year provision of § 67d(2) for the avoidance of liens and fraudulent transfers.

The bank claimants made a variety of responses. They denied having had any fiduciary relationship to Grant,

asserted that they had made loans in the belief fostered by Grant's management that Grant remained viable, contended that Grant's management itself had abandoned the proposed sale of accounts receivable, and denied that they had prevented Grant from seeking rehabilitation under the Bankruptcy Act. They asserted, moreover, that as to many U.S. Trust's claims, the remedy, even if the claim were made out, would be invalidation of the banks' security interests rather than subordination to the debentureholders. U.S. Trust also raised claims of conflict of interest and derelictions of duty against Chase, its predecessor trustee, to which Chase answered.

The settlement originally provided for the payment of 14% of the claims of the accepting subordinated debentureholders. All rights of non-acceptors were preserved, and neither the offer nor the bank settlement agreement was to have any effect in any proceeding brought by them. The indenture trustees, U.S. Trust and Citibank, were, however, to be released from all further obligations to enforce the rights of debentureholders under their respective indentures.

At a hearing before Judge Galgay objections were made by eleven debentureholders, led by Victor Kurtz as chairman of an "Ad Hoc Protective Committee of Holders of 4¾% Debentures", see note 5, *supra*, and represented by I. Walton Bader. A group of Institutional Investors also raised objections at the outset but have played no subsequent role in the case. The Kurtz objectors asserted principally that the Trustee had failed to make a presentation of the facts and law adequate to support approval of the settlement, that the bank claims should be equitably subordinated to the debentures because of the control and dominion over Grant allegedly exercised by the banks, and that the Trustee, U.S. Trust

and their respective counsel are subject to conflicts of interest which require them to be disqualified. Acknowledging the task imposed by *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson,* 390 U.S. 414, 424-25 (1968)[8], Judge Galgay, after 27 pages of discussion, 4 B.R. at 57-84, concluded that the original settlement represented a fair compromise, taking into account the strengths and weaknesses of the claims of both sides and the delay and expense incident to litigation,[9] and approved it on February 20, 1980.

Timely appeals were taken to the District Court (Conner, J.) by Kurtz and nine other debentureholders represented by Bader and Morton Robson (No. 80—Civ. 1857), and by debentureholder Levy and three others

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8 Initially we found it somewhat troubling that Judge Galgay applied the language of *Anderson* to the Trustee, 4 B.R. at 69, rather than to himself. While it is surely necessary that a trustee should perform these duties, his having done so does not relieve the bankruptcy judge from repeating the process, giving appropriate weight to the recommendations of the trustee and his counsel. However, Judge Galgay's opinion shows that he thoroughly understood this.

9 There has been much to-do about how far Judge Galgay's opinion represented his independent analysis as distinguished from a rubber-stamping of the findings of fact and conclusions of law prepared by counsel for the Trustee. Judge Galgay expressed, 4 B.R. at 57, his awareness of the caution in *United States v. El Paso Natural Gas Co.*, 376 U.S. 651, 656-67 (1964), that trial courts should not slavishly follow one party's proposed findings of fact and conclusions of law. He acknowledged having "adopted findings of fact and conclusions of law submitted by the Trustee for the reason that they accurately state and reflect the true state of the record" so that "[i]t would be a waste of judicial time on my part merely to rephrase proposed findings and conclusions so accurately stated." *Id.* At our request the counsel for the Trustee has made available his proposed findings and conclusions, and we have compared them with Judge Galgay's. We find that while Judge Galgay did adopt most of the Trustee's proposed findings of fact, especially as to the terms of the settlement, almost verbatim, he prepared his own legal discussion, and appellants' charge that the opinion was that of counsel rather than of the judge is a gross exaggeration.

represented by Bader and Bradley R. Brewer. The latter did not take an appeal on behalf of his present clients, David Cosoff and Helen Finkelstein, who were not named objectants but had asked Mr. Brewer to represent them at the time of the hearings before the Bankruptcy Judge. Before the appeals could be heard, negotiations looking toward an improvement of the offer were begun. Judge Conner stayed consideration of the appeals and allowed negotiations to go forward under the Bankruptcy Judge's supervision. See *In re W.T. Grant Co.*, 13 B.R. 1001, 1002 (S.D.N.Y. 1981). These resulted in an amended offer. The amount payable to the debentureholders was raised from a floor of 14 cents on the dollar to one of 19 cents on the dollar.[10] Interest on the reserve fund calculated from the date of approval by the bankruptcy judge would run for the benefit of the debentureholders. Solicitation of acceptances could start immediately. As soon as the tendering debentureholders were paid, the banks could also draw down the remainder of the $95,378,373 reserve fund set aside under the bank settlement agreement.

A conference on certain details was held in Judge Galgay's chambers on April 16, 1981. The appearance list shows Robson as appearing for "Kurtz et al." and Bader for "Bondholders". There was much discussion of the withdrawal of the appeals from Judge Galgay's order of February 20, 1980. Robson and Bader agreed that, subject to certain contingencies later worked out, they would withdraw their appeals with prejudice. Bader announced that although he had brought Brewer into the case and Brewer had signed his name on the briefs, Brewer was not

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[10] Additional amounts not in excess of 2 cents on the dollar might be paid if allowed fees and expenses amount to less than 2% of the face value of all debentures tendered.

the attorney for the Levy appellants, who were Bader's clients, and had not signed the notice of appeal. Robson's and Bader's stipulations withdrawing appeals from the February 20, 1980, order with prejudice and without costs were signed and so ordered.

In the further proceedings before Judge Galgay relating to the new settlement offer, objections had to be submitted in writing by June 12, with a hearing to be held on June 16. Brewer filed no written objections by June 12 because no one had authorized him to do so. A day later appellant Cosoff retained him to oppose the settlement. At the hearing on June 16 Judge Galgay gave him time to argue; Brewer there objected only to an alleged inadequacy of notice and to the provisions concerning attorneys' fees. By order dated June 23, 1981, Judge Galgay approved the amended offer, which has now been accepted by some 80% of the debentureholders. On July 1, 1981, Cosoff and Finkelstein, represented by Brewer, and Miller and McGinnis, originally represented by Douglas F. Eaton and now by Stuart E. Jackson, filed notices of appeal, which on this occasion came before District Judge Duffy. The grounds of appeal were largely those that had been argued before Judge Galgay at the hearing on the first settlement offer.[11] On March 15, 1982, Judge Duffy affirmed the order of the bankruptcy court, 20 B.R. 186 (S.D.N.Y. 1982), primarily on the ground that the dismissal of the appeals from the order of February 20, 1980, rendered that order *res judicata*. The instant appeals are from Judge Duffy's order.[12]

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[11] Judge Duffy noted, 20 B.R. at 189 n.4, that appellants had "arguably failed to preserve their claims for appeal by not properly articulating or presenting them in the bankruptcy court", but did not rely on this.

[12] An appeal was also taken by a number of debentureholders, all represented by Mr. Brewer, (No. 82-5021) which, because none of these

Discussion

Although the trustee in bankruptcy has not raised the point and U.S. Trust Company has done so only feebly, we begin by noting some concern whether appellants have standing to appeal in light of the fact that the settlement leaves them free to pursue their remedies. We see nothing in the argument of their counsel that they are entitled to represent accepting debentureholders since a rejection of the settlement would necessarily lead to a still further improvement in the offer. There can be no such assurance. Although the banks indeed moved rather quickly from 14 cents to 19 cents, there must be a point at which the banks would prefer to litigate rather than give up more in settlement, and no one knows but the banks and their counsel where that is. Beyond this there is no proof that accepting debentureholders have authorized appellants to appear for them. Appellants' argument with

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debentureholders had earlier appealed from the bankruptcy court to the district court, was dismissed for lack of standing without prejudice to later motions by these debentureholders for leave to intervene. Seventeen of this group, led by Robert B. Yates, have been granted permission to intervene and have amplified appellants' contention that the Bankruptcy Trustee's counsel should have been disqualified, *infra*, pp. 26-28. Another nine, led by James Stephan, have been allowed to intervene and have alleged conflicts of interest on the part of United States Trust Co., successor indenture trustee for the 4¼ debentures, and its counsel. In addition, leave to intervene was granted to a faction of debentureholders, led by John Masse and represented by I. Walton Bader, who support the amended offer of settlement but oppose United States Trust Co.'s application for fees pursuant to that offer. United States Trust Co. has also been permitted to intervene in support of the amended offer and in defense of its own conduct and that of its counsel.

The Stephan intervenors point to alleged conflicts of interest arising out of United States Trust Co.'s desire to obtain fees for its services and its potential liability for breaches of fiduciary duty committed by its predecessor Chase. We see no basis for the charges of misconduct leveled by the intervenors against United States Trust Co. and its counsel.

respect to standing must be rather that in a case of this sort the right of an individual debentureholder or even of a considerable group of such holders to assert their claims against the embattled forces of ten of the country's largest banks, once deprived of the resources afforded in the past by the bankruptcy trustee and the indenture trustee, is more fiction than fact. With claims of 80% of the debentures settled, the threat to the banks by a few holdouts is not substantial. Bringing the bankruptcy trustee, or the indenture trustee, or both, back to the negotiating table or to court is the only realistic recourse to preserve an opportunity for debentureholders who have not yet accepted to achieve more. The situation is comparable to that of court-approved settlements of class actions, in which "even where class members had the right to exclude themselves from the class, they may appeal from an order approving a settlement which they deem unsatisfactory," 3B Moore, Federal Practice ¶ 23.80[5] (2d ed. 1982), lest small claimants "be faced with equally unpalatable alternatives—accept either nothing at all or a possibly unfair settlement," *Ace Heating & Plumbing Co. v. Crane Co.*, 453 F.2d 30, 33 (3 Cir. 1971).

We have little doubt as to the correctness of Judge Duffy's observations about *res judicata* in the usual case or even in most cases of the approval of settlements in bankruptcy. An appeal by one creditor will not save the situation for another if the first withdraws his appeal—if for no other reason than that the time for the other to take an appeal will generally have expired. See 9 Moore, Federal Practice ¶ 204.11[4] (2d ed. 1982). Here the latter obstacle does not exist. The operative order was Judge Galgay's order of June 23, 1981, approving the revised settlement and the Cosoff-Finkelstein and Miller-McGin-

nis appeals were timely. By the time the Kurtz and Levy appeals from the February 20, 1980, order were withdrawn the amended offer had been made public and, if the appeals had not been formally withdrawn, Judge Conner would surely have found some way of getting rid of them rather than devote his time to hearing appeals from an order that was about to be superseded. Apparently the reason why withdrawal of the appeals was sought was to permit speedy dissemination of the new offer without having to await the the district court's decision as to the superseded offer, see 20 B.R. at 188; that purpose was accomplished. We see no indication that anyone thought at the time that the withdrawal of the appeals from the February 20, 1980, order with prejudice would deprive objectors to the new offer of a right to appeal on the merits if Judge Galgay were to approve this. Beyond all this, policy considerations weigh against a rigid application of *res judicata* when such serious attacks have been made upon the bankruptcy trustee and his counsel, the present and former indenture trustees for the 4¾% debentures, and the bankruptcy judge. We therefore proceed to Judge Duffy's alternative ground of decision, on which he did not elaborate, that the appeals are lacking in merit. 20 B.R. at 190. While we could remand the case to him to perform the task of a detailed analysis of the settlement and ordinarily would do so, nearly three years have elapsed since the initial approval of the settlement, and a remand and subsequent appeal would doubtless add nearly another year.

In undertaking an examination of the settlement, we emphasize that this responsibility of the bankruptcy judge, and ours upon review, is not to decide the numerous questions of law and fact raised by appellants but rather to canvass the issues and see whether the settlement

"fall[s] below the lowest point in the range of reasonableness", *Newman v. Stein,* 464 F.2d 689, 693 (2 Cir.), *cert. denied sub nom. Benson v. Newman,* 409 U.S. 1039 (1972). We shall not attempt to deal with every argument advanced by appellants but will concentrate on what seem the most nearly persuasive.

We start with appellants' argument that, quite apart from the banks' conduct, part or all of the banks' claims are not "Senior Indebtedness", see note 6, *supra*, to which alone the claims of debentureholders are subordinated. We can pass over the frivolous argument that the language does not cover further borrowings, to which Judge Galgay gave the treatment it deserved, 4 B.R. at 70-72. Appellants next argue that until Grant's guaranty of August 21, 1974, the banks' claims did not qualify as Senior Indebtedness of Grant since their loans were not to Grant but to Grant Financial. Judge Galgay thought a sufficient answer to be that Grant's indebtedness to Grant Financial was evidenced at the time of the filing of the Chapter XI petition by an Intercorporate Demand Note in the amount of $819,887,663, more than the amount of the banks' loans to Grant Financial, and that this would qualify as Senior Indebtedness if the corporate entities are respected; if they are not, as well might be proper, the loans to Grant Financial, all evidenced by notes, would qualify even more directly. Beyond this, the $15,000,000 Secured Demand Loans of August 1974 were originally made directly to Grant, and the $44,000,000 loaned under the Interim Loan and Guaranty Agreement of August 21, 1974, was guaranteed by Grant. Finally, under the Loan and Guaranty Agreement all loans by Grant Financial were guaranteed by Grant. While this did not become effective until October 8, 1974, which fell 6 days short of a year of the Chapter XI petition, there is no showing

that the trustee could have established lack of fair consideration for the guaranty under § 67(d). The legal standard in a situation such as this, which is governed by § 67(d)(1)(e) of the Bankruptcy Act, is whether "the economic benefit . . . that accrued to [the] bankrupt as a result of the third person's indebtedness" was " 'disproportionately small' when compared to the size of the security that that bankrupt gave and the obligations that it incurred," *Rubin v. Manufacturers Hanover Trust Co.*, 661 F.2d 979, 993 (2 Cir. 1981). See also *Klein v. Tabatchnick*, 610 F.2d 1043, 1047 (2 Cir. 1979). Through its subsidiary, Grant received the full benefit of the extended maturity of some $490,000,000 in short-term loans and additional loans up to the total amount of $600,000,000 in return for its guaranty and for security interests, see note 4, *supra*, estimated by the Bankruptcy Judge to amount to $288,000,000, 4 Bankr. Ct. Dec. at 606. We thus conclude that while the subordinated debentureholders have some arguments that the larger part of the bank debt would not qualify as Senior Indebtedness because the loans initially were made to Grant Financial rather than to Grant, these did not have much chance of prevailing.

Appellants contend that, however things might otherwise stand, the banks are estopped from claiming that Grant's indebtedness to Grant Financial constituted Senior Indebtedness because the prospectus under which the 4¾% Debentures were issued showed Senior Indebtedness of only $28,775,000 whereas Grant then owed Grant Financial $246,420,216. The Bankruptcy Judge accepted the Trustee's answer that where there is a conflict between a prospectus and the language of an indenture, the latter controls, citing *In re Discon Corp.*, 346 F. Supp. 839, 844 (S.D. Fla. 1971). Appellants' argument,

however, is not really one of construction; they say that even if the words are sufficient, Grant, allegedly with the banks' knowledge, acted in such a way as to make it inequitable for the banks to rely on the words. Yet even if this were upheld—and we find no proof of the banks' complicity in Grant's prospectus, the point remains that the prospectus goes on to define Senior Indebtedness as, *inter alia,* "indebtedness . . . for money borrowed from or *guaranteed to* persons, firms or corporations evidenced by notes or similar obligations" (emphasis supplied). Grant's fresh guaranty of the indebtedness of Grant Financial to the banks in 1975 would itself therefore qualify as Senior Indebtedness even if some principle of estoppel were to prevent the banks from claiming that the unguaranteed intercorporate loans from Grant Financial would not have done so in 1971.

Once it is concluded that there was a strong probability that all of the bank debt would be deemed Senior Indebtedness and a certainty that some of it would be, appellants' other claims lose much of their force. It is true, as appellants urge, that the contractual subordination of the debentures to the bank debt would not prevent the bankruptcy court, as a court of equity, from placing the debentures on a plane of equality with or even, although this is harder to envision, see note 7, *supra*, of superiority to all or part of the Senior Indebtedness if the banks had engaged in inequitable conduct. However, what appellants disregard is that in judging the equity of the banks' conduct their position as creditors *prima facie* senior to the debentureholders must be taken into account. We see no reason to quarrel with the substance of Judge Galgay's summary of the law of equitable subordination, 4 B.R. at 74-75, although every judge would probably state his own version differently. We entirely agree with his conclusion

that "[a] creditor is under no fiduciary obligation to its debtor or to other creditors of the debtor in the collection of its claim", 4 B.R. at 75, and cases there cited. See *Weinberger v. Kendrick,* 81-7317, slip ops. at 3923, 3957 (2 Cir. July 14, 1982). The permissible parameters of a creditor's efforts to seek collection from a debtor are generally those with respect to voidable preferences and fraudulent conveyances proscribed by the Bankruptcy Act; apart from these there is generally no objection to a creditor's using his bargaining position, including his ability to refuse to make further loans needed by the debtor, to improve the status of his existing claims.

Returning to the four principal points raised by objectors, see pp. 8-9, *supra*, we thus think the bankruptcy judge was warranted in giving relatively little weight to those labeled as (a) and (b). The premise of both arguments is that sometime between September of 1974 and May of 1975 the banks knew or had reasonable grounds to believe that Grant was insolvent. Although the Trustee had alleged this in his answer to the banks' claims, we have been cited to no evidence that would support this. To the contrary there was much testimony that Grant continued showing a substantial net worth and that the banks considered it viable almost to the end.

Taking up next the objection lettered (d), the gravamen of this charge is that Grant management, apparently in the summer of 1974, contemplated taking action to place Grant in a Chapter XI proceeding, which might have enabled Grant to survive as a reduced operation with lower administrative expenses, but that the banks prevented this, making specious explanations but acting in reality to improve their preferred position. For this appellants cited pasages from two depositions neither of which supports the contention they advance. In the first of

appellants' references, John P. Schroeder, Morgan Guaranty's officer in charge of the Grant credit, merely agreed with questions suggesting that in the late summer of 1974 the banks wished "to recoup the most amount of money as possible on the Grant loans", an understandable and permissible desire, and that for this reason they "did not opt for liquidation at that time". In the second passage cited, Robert Dannenbaum of the Bank of New York stated that at some unspecified time the banks would have liked an "unofficial reorganization program", by which he meant not a Chapter XI proceeding but rather nothing more than "general monitoring of the Company's affairs by the banks". No suggestion is found in any passage of these witnesses' testimony reproduced by appellants that Grant itself actively contemplated undergoing voluntary liquidation or reorganization under the Bankruptcy Act in the summer of 1974. We also note that after July, 1974, the banks increased their loans by $44,000,000 in August, 1974, and by another $66,587,500 in October, 1974, and on September 15, 1975, subordinated $300,000,000 of their debt to trade obligations. While a sinister interpretation is possible, this is not demanded; considering that the fresh money provided by the banks after July, 1974, amounted to some $226,000,000 as against $95,378,373 principal amount of the debentures, the banks would have been paying a rather high price to obtain whatever legal advantages the various arrangements of July, 1974, through September, 1975, would yield in the event of Grant's invoking the Bankruptcy Act.

With respect to objection (d), the Bankruptcy Judge was warranted in attaching little importance to general statements by Grant officials that the banks were "running" Grant. There is no doubt that, at least from March

of 1974, the banks kept careful watch on what was going on at Grant; they would have been derelict in their duty to their own creditors and stockholders if they had not. It is not uncommon in such situations for officers whose companies have been brought to the verge of disaster to think that they still have better answers than do the outsiders. In order to establish their claims the appellants must show not simply that the banks proffered advice to Grant that was unpalatable to management, even advice gloved with an implicit threat that, unless it were taken, further loans would not be forthcoming. They must show at least that the banks acted solely for their own benefit, taking into account their reasonable belief that their claims constituted Senior Indebtedness vis-a-vis the debentureholders, and adversely to the interest of others.

The allegation most discussed by appellants is that lettered (c). With respect to this the record, along with materials submitted in support of and in response to the petition for rehearing in *Weinberger v. Kendrick, supra,* enable us to piece out the story. Harry Pierson, the acting president of Grant and Robert Luckett, the controller, made a report to a meeting of the Grant board of directors in June of 1974 proposing a transaction wherein \$100,000,000 of customer accounts receivable would be sold to Beneficial Finance Company (Beneficial) at a discount of up to 27% and some undetermined portion of the proceeds[13] would be used to purchase on the market 4¾% subordinated debentures which were then selling at about 25 cents on the dollar. Pierson reported that two of

[13] As the transaction was conceived, Grant would use for repurchase of subordinated debentures so much of the proceeds as was needed to have the resulting paper reduction in subordinated debt on the right hand side of Grant's balance sheet offset the loss of assets on the left hand side engendered by the discounted sale of the accounts receivable

the major banks, Morgan Guaranty and Chase, were opposed to the transaction until some time after the completion of the proposed bank loan commitment, presumably the Loan and Guaranty Agreement executed on October 8, 1974. Their reasons were that proceeds of one of Grant's most valuable assets would be used to pay junior debt and that trade creditors would be upset. According to Luckett, Pierson had nevertheless determined to sign the contract with Beneficial and apparently persisted in that intention after a meeting at Morgan Guaranty where the banks' opposition was strongly conveyed. However, when Grant's attorneys received the documents from Beneficial, they found, as often happens in negotiations of this sort, that the provisions were distinctly more onerous than the Grant officers had supposed. For example, Beneficial reserved the right to cull the accounts tendered, would make no payment until 30 days elapsed, and could put back to Grant any accounts that it found difficult to collect. These and numerous other snags in the draft agreement led Charles A. Doyle, then an attorney in Grant's Legal Department, to report to Robert Kelly, his superior, that "it would be legally unwise and unsound to execute any of these agreements in their present form." This view was shared by Kelly, as well as by John Sundman, Grant's new Financial Vice President and its closest link with the banking community.

It would seem a sufficient answer to the objectors that the Beneficial deal was abandoned for reasons relating to its terms that were entirely independent of the banks' opposition. Beyond that we think it would have been surprising if the banks had not objected to the portion of the transaction which involved use of proceeds of quick assets to purchase long-term subordinated debt. The

banks reasonably thought that their claims were senior to the debentures. True, the purchase of debentures at 25 cents on the dollar would have meant a saving of interest of some 19% on the purchase price. But Grant's immediate problem was short term; what it needed was to conserve resources and obtain short-term loans in order to stay afloat until the tide turned. Even if we should assume the evidence went so far, we see nothing inequitable in the banks taking the position that if Grant wished use quick assets to redeem subordinated long-term debt, even on an advantageous basis, it could expect no further help from them.

The appellants raise a special point concerning Chase. As previously stated, Chase, one of the three lead banks, had been Indenture Trustee for the 4¾% debentureholders until August, 1974, when it resigned and was succeeded by U.S. Trust. A debentureholder accepting the offer of settlement releases his claim against both.[14] Despite the limited duties of a trustee for debentureholders, as distinguished from a trustee holding property as security, it is settled in this circuit that he owes a duty "not to profit at the expense of his beneficiary", *Dabney v. Chase Nat'l Bank*, 196 F.2d 668, 670 (2 Cir. 1952) (L. Hand, J.), *as supplemented*, 201 F.2d 635 (2 Cir.), *cert. dismissed per stipulation*, 346 U.S. 863 (1953). See also *United States Trust Co. v. First National City Bank*, 57 A.D.2d 285, 296, 394 N.Y.S.2d 653, 660-61 (1st Dep't 1977), *aff'd*, 45 N.Y.2d 869, 410 N.Y.S.2d 580 (1978); *Broad v. Rockwell Int'l Corp.*, 642 F.2d 929, 959-60 (5 Cir.) (en banc) (construing New York law), *cert. denied*, 454 U.S. 965 (1981); *Morris v. Cantor*, 390 F.Supp. 817, 824 (S.D.N.Y.

[14] We see no basis whatever for any claims against U.S. Trust or its counsel, *supra*, note 12.

1975). When an indenture trustee assumes the role of a lender, it takes the risk that, in the event of insolvency of the issuer, its acts will be subject to special scrutiny. Here the Bankruptcy Trustee conducted an examination of Chase's files covering its activities as indenture trustee, and objector Kurtz deposed a Chase vice president concerning its decision to resign as indenture trustee and other matters. Neither the deposition nor any of the exhibits marked thereat were offered in evidence at the hearing on objections. In their briefs in this court objectors rely on Chase's having played a principal role in the opposition to the sale of accounts receivable to Beneficial Finance Co. and having participated in the negotiation and drafting of the agreements of the summer and fall of 1974.

At first blush the argument that Chase helped to thwart a plan whereby at least some of the debentureholders would have received partial payment might seem to have possible merit. However, it falls on the rock of so much of our previous discussion as shows that Grant would not have consummated the Beneficial deal apart from the banks' opposition. The second argument falters on the fact that the $44,000,000 of secured loans covered by the Interim Loan and Guaranty Agreement were new money, $12,480,000 of which was supplied by Chase. Even if the facts showed that Chase participated in negotiation of the October 8, 1974, Loan and Guaranty Agreement while still indenture trustee, which is not at all clear, this also involved $66,587,500 of new money, $17,973,000 of which was supplied by Chase. This is some distance from the acts of "[a] creditor who accepts payment of part of a loan before it is due, from a debtor known to be 'fighting for its life', and who insists upon security for the balance [of unsecured debt] when it is due", of which Judge Hand

wrote in *Dabney, supra,* 196 F.2d at 672. As the Fifth Circuit en banc recently concluded, New York authority runs contrary to the assertion "that an indenture trustee has a duty, fiduciary or otherwise, to seek for the holders of debentures any benefits that are *greater* than those contractually due them," *Broad v. Rockwell Int'l Corp., supra,* 642 F.2d at 959 (emphasis in original). In short, while Chase might have been better advised to resign at an earlier date we see little prospect of a recovery against it as indenture trustee on the facts before us.

The only other contention of appellants we deem worthy of discussion is their position that Weil, Gotshal & Manges (WGM) should have been disqualified as attorneys for the Bankruptcy Trustee. Although their argument is cast in terms of disqualification, what appellants are really saying is that WGM's allegiance to the banks led the firm to make an inadequate investigation of the claims of preferences, fraudulent conveyances, and so forth, raised in the Trustee's answer in the adversary proceeding initiated by the banks and, in part because of this lack of investigation, to recommend a settlement too favorable to the banks. The claimed bases for "disqualification" are that:

(1) WGM acted as counsel for the bank claimants for five days after the initiation of the Chapter XI proceeding and before it was retained as co-counsel by a creditors' committee representing both the bank and other claimants;

(2) WGM was one of two co-counsel representing the creditors committee throughout the Chapter XI proceeding and until its engagement as counsel for the Trustee in liquidation;

(3) From February, 1975, until April, 1977, WGM acted as counsel for Morgan Guaranty in connection with a $9,000,000 claim against Bowmar Instrument Corp. in a Chapter XI proceeding;

(4) Until 1975, WGM was counsel for Shapiro Brothers Factors Corp., a wholly owned subsidiary of Chase, and it now represents Chase Manhattan Mortgage and Realty Trust, a publicly owned real estate investment trust with ties to Chase.

Judge Galgay overruled this claim, 4 B.R. at 82, partly in reliance on § 44c of the Bankruptcy Act, which provides:

> An attorney shall not be disqualified to act as attorney for the receiver or trustee merely by reason of his representation of a general creditor.

Appellants answer that their objection goes to WGM's affiliations not with general creditors but with institutions claiming to be lien creditors.

However, we do not find that any of the relationships charged by appellants were disqualifying. The five days of representation of the bank claimants were *de minimis*; appellants point to no action taken during that period on WGM's advice which figured in the later investigation or negotiations.[15] We likewise have been pointed to no disqualifying action taken while WGM was co-counsel for the creditors' committee in the Chapter XI proceeding. Although appellants allege it was understood that WGM

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[15] It would appear that the bank claimants had already acted to set-off $94,523,110 of Grant's funds on deposit with them and to advance back $90,300,000 of this amount to Grant as debtor-in-possession by October 2, 1975, prior to the start of WGM's challenged five-day representation of the bank claimants.

was representing the banks and the co-counsel, Ballon, Stoll & Itzler, were representing other creditors, we have been shown nothing to substantiate this or to show that WGM was advancing the cause of the banks in this case. We see no reason to disagree with Judge Galgay's reaffirmation, 4 B.R. at 83, of his conclusion in *In re REA Holding Corp.*, 4 Bankr. Ct. Dec. 1249, 1253 (Bankr. S.D.N.Y. 1979), *vacated and remanded on other grounds*, 2 B.R. 733 (S.D.N.Y. 1980), that "[t]he role of counsel to an official creditors' committee is not adverse to or in conflict with the role of counsel to a bankruptcy trustee if liquidation should subsequently ensue." WGM's previous representation of one or more of the banks or their subsidiaries in unrelated matters is scarcely a ground for disqualification. There is no contention that WGM regularly served any of the banks in bankruptcy cases, and their having done so in one or more unrelated cases would not prevent a vigorous assertion of the claims of the subordinated debentureholders against the banks. On an issue of this sort particular weight should be given to the conclusion of the Bankruptcy Judge, who had abundant opportunities to observe the activities of WGM over many months and concluded "that the Trustee's attorneys have served him and the creditors of the bankrupt estate with vigor, objectivity and independence."

We conclude by reemphasizing that the task of the bankruptcy judge was not to determine whether the settlement was the best that could have been obtained, something that neither he nor we can ever know, but whether it "fall[s] below the lowest point in the range of reasonableness", *Newman v. Stein, supra*, 464 F.2d at 693. If we take the Trustee's estimated realization of $600,000,000, and deduct the estimated $143,000,000 of administration and § 64a priority claims, the $76,000,000

owing to secured suppliers, and the $24,000,000 owing to senior debentureholders, there would be a balance of $357,000,000 available for distribution among $650,000,000 of bank claims, $95,000,000 of Subordinated Debentures and $82,000,000 of general unsecured claims, 4 Bankr. Ct. Dec. at 606. If the banks could sustain their claims of subordination, let alone their claims of lien protection for $288,000,000 of their debt, the subordinated debentureholders would take nothing. Even if the banks' claims to secured creditor status and subordination of the debentures were rejected but the banks were not subordinated to them, all of which was highly problematical, the debentureholders would receive only 43 cents on the dollar, after much further expense. After considering the strengths and weaknesses of the claims of the debentureholders a settlement assuring them of 19 cents can hardly be regarded as below the lowest point in the range of reasonableness.

We therefore affirm the judgment of the district court on the merits.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re W.T. GRANT COMPANY, Bankrupt.	:	81 Civ. 5996 (KTD)
DAVID COSOFF, HELEN FINKELSTEIN, EILEEN MCGINNIS, JAY MILLER, Appellants, - against - CHARLES G. RODMAN, Trustee-Appellee.	:	<u>OPINION</u>

APPEARANCES:

WEIL, GOTSHAL & MANGES
Attorney for the Trustee
767 Fifth Avenue
New York, New York
Of Counsel: Harvey Miller, Esq.
Richard Krasnow, Esq.

BREWER & SOEIRO
799 Broadway
New York, New York
Of Counsel: Bradley R. Brewer, Esq.

DOUGLAS F. EATON, ESQ.
Attorney for Appellants
Eileen McGinnis and Jay Miller
598 Madison Avenue
New York, New York
Of Counsel: Joanne C. Eaton, Esq.

KEVIN THOMAS DUFFY, D.J.:

David Cosoff, Helen Finkelstein, Eileen McGinnis and Jay Miller appeal pursuant to Bankr.R.P. 801 from Bankruptcy Judge Galgay's order approvidng a settlement between banks and subordinated debentureholders of bankruptcy W.T. Grant Company ("Grant"). The settlement offers debentureholders 19 cents on the collar.[1/] Appellants argue that Judge Glagay committed errors of law and fact in approving the settlement and in providing notice to debentureholders. It is unnecessary, however, to address these arguments. Appellants' claims were litigated to a final judgment in bankruptcy court two years ago, and are thus _res judicata_.

This matter arises out of the attempt of Grant's bank creditors to collect some $657,000,000 by enforcing liens and guarantees after the company was adjudicated a bankrupt on April 13, 1976. Appellee Charles G. Rodman, bankruptcy trustee, challenged the validity of the liens and guarantees on

the ground that the banks had obtained their sureties by dominating Grant management to the prejudice of the company in the eighteen months before bankruptcy. Chase Manhattan Bank, N.A., and Citibank, N.A., had been both Grant lenders and indenture trustees for the debentureholders[2/] during the events in question, so these banks appeared to have a conflict of interest. Rodman argued that under the doctrine of equitable subordination the $94,000,000 in subordinated debentures should be paid in full before the banks received any money from the bankrupt's estate. See Pepper v. Litton, 308 U.S. 295-307-310 (1939).

The trustee accumulated about $700,000-000 by liquidating the estate. Some $94,000-000 was set aside to meet the debentureholders' claims in case they won; otherwise the money would go to the banks as senior creditors. The trustee litigated against the banks for about one year. He deposed more than twenty-five witnesses and took more than 10,000 pages of testimony. Settlement nego-

tiations began in late 1977 or early 1978. The trustee recommended a settlement for 14 cents on the dollar, and after five days of hearings in May, 1979, Judge Galgay approved the settlement on February 20, 1980. In re W.T. Grant, 4 Bankr. 53 (Bankr. S.D.N.Y. 1980). The settlement provided that debentureholders would accept a cash payment of 14 cents on the dollar by tendering their securities and waiving all claims against the banks.[3/] Funds would be disbursed out of the $94,000,000 reserve fund only after 90 percent of the debentureholders (or such lower percentage as the banks would choose) had accepted the offer. The trustee would retain funds sufficient to cover 100 percent of the principal and accrued interest on claims of debentureholders who refused the settlement. The settlement offer would not be distributed to the debentureholders, and no money would be paid out, until appeals of the settlement were exhausted.

Eleven debentureholders appealed from Judge Galgay's order to the district court.

Cosoff, Finkelstein, McGinnis and Miller were not among them. Cosoff and Finkelstein had objected to the settlement in bankruptcy court and had been represented by their present attorney Bradley R. Brewer. Brewer participated in the appeal of Judge Galgay's order, but in his brief he admits that he did not appeal on behalf of Cosoff and Finkelstein because he did not think it necessary to protect their rights.

Negotiations continued while the appeal was pending, and the district court issued a limited remand so that Judge Galgay could supervise the negotiations. On April 1, 1981, the parties reached a compromise; the banks raised their settlement offer to 19 cents on the dollar. In return, the objectants agreed to dismiss their appeal with prejudice. Lawyers for the banks worried that parties not present might try to block the settlement, but Harvey Miller, counsel to the trustee, observed that withdrawal of the appeal would make Judge Galgay's decision final and allow the parties

to disseminate the settlement offer.

Mr. Brewer participated in the settlement conference in Judge Galgay's chambers, but he was unable to state for the record exactly who he was representing. He made no effort to contact his clients to intervene in the appeal or otherwise keep it alive. Mr. Brewer knew of the 19-cent settlement on April 1, 1981, but he received no objection from any client to the offer by June 8, when he was informed that all objections to the new settlement had to be submitted to the bankruptcy court in writing by June 12. Mr. Brewer submitted no written objections because he had received none by that date. Judge Galgay approved the 19-cent settlement on June 16. Mr. Brewer appeared at the hearing on June 16, but he was still uncertain as to who he represented. Only Mr. Cosoff had retained him to oppose the settlement, and Mr. Cosoff had acted on June 13, one day after the deadline for submitting objections. Judge Galgay gave Mr. Brewer a limited time to argue in court against the settle-

ment. Mr. Brewer chose to object only to the adequacy of notice--he claimed the June 8-12 interval was too little time, and he claimed the notice of settlement was confusing--and to attorneys' fees incorporated in the settlement.[4/]

The settlement offer was distributed, and about $79,300,000 or 80 percent of the debentures have been exchanged in acceptance of the settlement. The banks approved disbursement of cash pursuant to the settlement.[5/] It is this executed settlement[6/] that appellants, again represented by Brewer,[7/] seek to undo.

Two years after the bankruptcy court approved the 14-cent settlement, appellants here raise only the same claims that were litigated before Judge Galgay. Judge Galgay's decision was res judicata. Katchen v. Landy, 382 U.S. 323, 334 (1966). Even though the bankruptcy proceeding continued, appellants could attack the decision only by direct appeal. In re Abilene Flour Mills Co., 439 F.2d 937, 939 (10th Cir. 1971); Kimm v. Cox, 130 F.2d

721, 736-37 (8th Cir. 1942).This they failed to do. Therefore, they may not litigate their claims a second time through this appeal.

Appellants argue that Judge Galgay's decision was challenged on appeal by the original objectants. They reason that because they were not parties to the first appeal, the dismissal of the appeal does not bind them and in some way reopens Judge Galgay's decision to their attack. This argument mistakes the effect of res judicata in bankruptcy.

A bankruptcy is essentially an in rem proceeding of an equitable nature. Local Loan Co. v. Hunt, 292 U.S. 234, 241 (1934); Moore, Res Judicata and Collateral Estoppel in Bankruptcy, 68 Yale L.J. 1, 1 (1958); 1 Collier on Bankruptcy, ¶2.09, at 173 & n.3 (J. Moore & L. King 14th ed. 1974). The bankruptcy court adjudicates interests in the res, which is the bankrupt's estate in general and the $94,000,000 reserve fund in this particular case. A judgment in rem binds all parties in the world who have notice of the proceeding as to their interests in the res.[8/] Restatement of Judgments

Section 73(1) (1942); Restatement (Second) of Judgments, Section 73(a) & Comment (a) at 192 (Tent. Draft No. 1 1973).

In Stoll v. Gottlieb, 305 U.S. 165 (1938), the bankruptcy court approved over creditor Gottlieb's protests a reorganization plan which required Gottlieb and other creditors to give up their claims against guarantors of the debtor. Gottlieb did not appeal the bankruptcy court's decision that it had jurisdiction to bind Gottlieb as against the guarantor, and the Supreme Court held the decision *res judicata* against Gottlieb when he sued the guarantor in state court.

In Chicot County Drainage Dist. v. Baxter State Bank, 308 U.S. 371 (1940), the bondholders with notice of a municipal bankruptcy proceeding but who never participated in the proceeding challenged the bankruptcy court's adjudication after the Supreme Court, in another case, held the municipal bankruptcy law unconstitutional. The bondholders argued the bankruptcy court lacked subject mat-

ter jurisdiction. Even though the bondholders never participated in the proceeding, the Court held the decision of the bankruptcy court res judicata. Id. at 375. See Moore, supra, 68 Yale L.J. at 7-10.

The cases as analyzed above indicate that a creditor with notice may not contest a decision of the bankruptcy court once that decision has become final, whether or not the creditor appeared before the bankruptcy judge. It would seem to follow that a creditor may not contest a decision of the bankruptcy court on appeal after a first appeal has been withdrawn and the time to join in that appeal has expired. See Bankr.R.P. 802(a).[9/] It is not the capitulation of the original appellants which binds the appellants here. See Robinson v. First Nat'l City Bank, 482 F. Supp. 92 (S.D.N.Y. 1979) (litigating creditors in bankruptcy are not class representatives and do not bind fellow creditors). It is instead appellants' own failure to join in the original appeal.

To allow appellants a second chance at review would permit yet a third appeal should these appellants settle with the banks. A decision permitting such a result would disserve the goal of finality in litigation which is the purpose of res judicata. See Federated Department Stores, Inc. v. Moitie, 49 U.S.L.W. 4687 (1981) (where five of six plaintiffs dismissed by the same judge won on appeal because of an intervening change in law, the district court decision remained res judicata against the non-appealing plaintiff). Moreover, appellants present no good reason for relief from res judicata. The first appeal was not a sham; no procedural inequity is apparent.[10/] Nor will any substantive injustice result from this application of res judicata. The settlement appellants seek so hard to upset explicitly preserves to them and all other dissenting debentureholders both their cause of action against the banks and a reserve fund from which to collect. In any event, this appeal is totally devoid of merit. Judge Galgay care-

fully considered the settlement over six days of hearings, and the opinion of the court, though drawn from the statement of the trustee, contains no error sufficient to constitute an abuse of discretion.

The order of the bankruptcy court is affirmed and costs will be assessed against the appellants.

SO ORDERED.

Dated: New York, New York
March 15, 1982

/s/ KEVIN THOMAS DUFFY, U.S.D.J.

FOOTNOTES

1. The settlement actually provides for a gross payment of 21 cents on the dollar; it provides that no more than 2 cents on the dollar will go towards attorneys' fees, leaving debentureholders with a net settlement of at least 19 cents on the dollar.

2. There are actually two different groups of debentureholders in this proceeding: those holding 4.75 per cent subordinated debentures totalling $92,507,000, and those holding 4 percent subordinated debentures totalling $834,000. Citibank was the indenture trustee for the 4-percent debenture holders; Chase Manhattan was the indenture trustee for the 4.75 percent debentureholders until August 14, 1974, when it resigned and was replaced by the United States Trust Company of New York. Appellants here hold only 4.75 subordinated debentures. Because I hold that Judge Galgay's 1980 decision is res judicata against all subordinated debentureholders, I do not consider appellee's argument that appellants cannot affect the validity of the settlement on behalf of the 4-percent holders.

3. The first settlement provided for a gross payment of 15 cents on the dollar, with no more than 1 cent going towards attorneys' fees.

4. Appellants arguably failed to preserve their claims for appeal by not properly articulating or presenting them in the bankruptcy court. In re REA Holding Corp., 2 Bankr. 733, 737 (S.D.N.Y. 1980); In re Bildisco, 11 Bankr. 1019, 1020 (D.N.J. 1981). Appellee in turn first presented his res judicata argument in this appeal. However- neither side contends here that the other has waived a claim or defense by failing to present it to the bankruptcy court. Omission of res judicata arguments below is understandable: Mr. Brewer's failure to comply with the bankruptcy court's procedures deprived the trustee of notice that a res judicata defense would be necessary. For this reason, and in the absence of any waiver argument by appellants, I think appellee's res judicata argument is properly before this Court. To rule otherwise would reward appellants for their failure to comply with procedures below.

5. Appellants tried and failed to obtain a stay of the cash disbursement. The banks guaranteed return of the case should this appeal go against them.

6. Cf. Bankr.R.P. 805 (Unless an order approving sale of property is stayed pending appeal, a good faith purchaser of the property shall not be affected by reversal or modification of the order).

7. The notice of appeal was filed by Mr. Brewer. Mr. Eaton later appeared as co-counsel for the appellants.

8. The appellants do not claim that they lacked notice of the bankruptcy proceeding.

9. See 9 Moore's Federal Practice, ¶204.11[4] at 4-54-55 (J. Moore, B. Ward & J. Lucas 2d ed. 1980) (though parties may have identical interests, one who appeals under Fed.R.App.P. 4(a) does not stand as surrogate for one who does not, and those failing to appeal may not challenge judgment of the trial court). Bankr. R.P. 802(a) is modeled after Fed.R.App. 4(a). Bankr. R.P. 802 advisory committee note.

10. Appellants complaint that they recieved no notice of the original appellants' decision to withdraw their appeal with prejudice. This argument contains neither legal nor factual merit. The present appellants had knowledge of the original order and could have joined in the original appeal. Withdrawal of the appeal occurred long after the appellants' time to join the appeal had lapsed. It is settled law that appellants were owed no notice of the order from which appeal was taken. See In re General Insecticide Co., 403 F.2d 629, 630 (2d Cir. 1968); In re St. Cloud Tool & Die Co., 533 F.2d 387, 390 (8th Cir. 1976). It is difficult to see how appellants were owed notice of a withdrawal of an appeal if they were not owed notice of the original order. Finally, Mr. Brewer, who admits in his brief that he represented appellants before the bankruptcy court, did have notice of the decision to withdraw the first appeal.